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THE INTERNATIONAL SECURITIES ENFORCEMENT COOPERATION ACT OF 1988

HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

S. 2544

TO AMEND THE FEDERAL SECURITIES LAWS IN ORDER TO FACILITATE COOPERATION BETWEEN THE UNITED STATES AND FOREIGN COUNTRIES IN SECURITIES LAW ENFORCEMENT

JUNE 29, 1988

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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CONTENTS

WEDNESDAY, JUNE 29, 1988

Page

Opening statement of Senator Riegle 1
  Complete prepared statement of Senator Riegle 20
Opening statements of:
  Senator Sasser 2
  Senator Shelby 3
  Senator Garn 6
  Senator D'Amato 7
Proposed bill, S. 2554 10

WITNESSES

David S. Ruder, Chairman, Securities and Exchange Commission; accompanied by Gary Lynch, Director, Enforcement Division, Securities and Exchange Commission 24
  Increase of foreign participation in the securities markets 24
  Using foreign jurisdiction 25
  International securities enforcement 26
  Authority to improper activity abroad is limited 27
  Prepared statement 28
    Introduction and summary 28
    I—International participation in the U.S. securities markets 30
    II—Commission initiatives for exchanging and obtaining information 30
      A. The Commission's memoranda of understanding 30
      B. Informal arrangements and contacts with foreign authorities 32
      C. Unilateral action 34
      D. International securities enforcement act of 1988 35
    Conclusion 45
Panel discussion:
  The Wang-Lee case 46
  Other cases under investigation 48
  Working with Switzerland 48
  Increase of enforcement personnel 50
  Obtaining information from abroad 51
  Reciprocal arrangements 53
  Response to written questions of:
    Senator Proxmire 66
    Senator Riegle 69
    Senator D'Amato 70
Mary V. Mochary, Principal Deputy Legal Adviser, U.S. Department of State 57
  Explanation of unilateral enforcement 57
  Negotiate bilateral mutual assistance treaties 58
  Reciprocity requirements 59
  Prepared statement 60
  Response to written questions of:
    Senator Proxmire 76
    Senator Riegle 75

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

U.S. Department of Justice, statement from Mark M. Richard, Deputy Assistant Attorney General, Criminal Division 77
U.S. Department of State, statement from John C. Whitehead, Deputy Secretary of State 82

THE INTERNATIONAL SECURITIES ENFORCEMENT COOPERATION ACT OF 1988

WEDNESDAY, JUNE 29, 1988

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Subcommittee on Securities,
Washington, DC.

The committee met at 10:10 a.m., in room SD–538, Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the subcommittee) presiding.

Present: Senators Riegle, Shelby, Garn, D'Amato, and Hecht.

OPENING STATEMENT OF SENATOR RIEGLE

Senator **Riegle**. The subcommittee will come to order.

I apologize for the late start. Governor Dukakis is in town this morning and had asked to meet with some of us and he was late in arriving so we're a little bit behind. I appreciate the patience of all who are here.

Senator D'Amato will need to leave in a second and has a statement I think he wants to insert in the record. Senator D'Amato.

Senator **D'Amato**. Mr. Chairman, thank you, and I want to commend you for calling these hearings.

I have a statement not only on behalf of myself but another one on behalf of Senator Garn that I'd like to submit for the record as if both of them were read in their entirety.

Senator **Riegle**. Senator Shelby.

Senator **Shelby**. Mr. Chairman, I have a written statement that I would like to submit for the record. I also want to commend you for holding this hearing; I know we've got very important witnesses here today and I'd like to get on with their testimony.

Senator **Riegle**. Without objection, so ordered.

[Committee insert of Senators Sasser, Shelby, Garn, and D'Amato statements.]

[Copy of proposed bill, S. 2544 follows:]

STATEMENT OF SENATOR JIM SASSER, SENATE SECURITIES SUBCOMMITTEE, JUNE 29, 1988

MR. CHAIRMAN, I WISH TO COMPLEMENT YOU ON YOUR LEADERSHIP IN INTRODUCING THE "INTERNATIONAL SECURITIES ENFORCEMENT COOPERATION ACT." I THINK THAT THIS IS IMPORTANT AND NEEDED LEGISLATION.

CLEARLY, THE OCTOBER STOCK MARKET CRTASH BROUGHT HOME TO US THE DEGREE TO WHICH THE SECURITIES MARKETS HAVE BEEN INTERNATIONALIZED. MOREOVER, SEVERAL OF THE INSIDER TRADING CASES THAT THE SEC HAS PURSUED HAVE HAD VERY SIGNIFICANT INTERNATIONAL OVERTONES.

MR. CHAIRMAN, ANY TOOLS THAT WE CAN MAKE AVAILABLE TO THE SEC TO INCREASE ITS ENFORCEMENT CAPABILITY IN INTERNATIONAL MARKETS SHOULD BE CONSIDERED. [redacted]. CONFIDENCE AND TRUST IN OUR SECURITIES MARKETS SHOULD EXTEND WORLDWIDE.

INDEED, IF IT APPEARS THAT THE MARKETS ARE BEING MANIPULATED FOR THE BENEFIT OF A FEW, AND THE SEC DOES NOT HAVE THE APPROPRIATE ENFORCEMENT TOOLS AVAILABLE, THE CAPITAL RAISING PROCESS WORLDWIDE WOULD SUFFER.

THANK YOU MR. CHAIRMAN. I LOOK FORWARD TO TODAY'S TESTIMONY.

Statement by SENATOR RICHARD SHELBY June 29, 1988

Mr. Chairman, rarely is there a bill which comes before the Senate, especially before the Senate Banking Committee, that everyone agrees is a good idea and would be beneficial for all Americans.

S.2544 is such a bill.

The International Securities Enforcement Cooperation Act, sponsored by my good friend Senator Riegle of Michigan, as well as by the distinguished Chairman Mr. Proxmire and the senior Senator and ranking Republican member from Utah, Mr. Garn, would assist security officials in the United States as well as their counterparts in the other free, industrial nations.

With S. 2544, both Congress and the Securities and Exchange Commission realize that as the security markets become more internationalized, we are faced with more danger of insider trading. My colleagues and anyone with a knowledge of the financial world can remember vividly the cases of Ivan Boesky and Dennis Levine. Just yesterday, the SEC charged an analyst of the Morgan Stanley company named Stephen Wang with leaking information that a Taiwanese citizen, Fred Lee, parlayed into a $19 million dollar profit. S.2544 would encourage this international mutual assistance.

We can already see the advantages that the SEC's bilateral memorandums of understanding [MOU] have created with Canada, Switzerland, the United Kingdom, and Japan. This bill would expand these MOU's to provide for mutual investigative authority for countries around the world similar to those MOU's which already exist.

S.2544 also contains a number of other provisions that would be approved by both brokers and investors alike, including the assurance that nonpublic information provided by foreign countries will remain confidential. The United States is the only nation with a Freedom of Information Act; other nations do not usually wish to make public information that they confidentially share with the SEC. This bill, proposed by Senator Riegle with the assistance of the SEC, states that the confidentiality of this information will be guaranteed unless a law enforcement proceeding was initiated. This provision will increase the flow of information between America and the financial powers of Western Europe and the Far East

Perhaps, S.2544 is not perfect; I have yet to discover any bill that is. We must discuss how we are to convince other nations that they should increase their freedom of information and write into their lawbooks reciprocal agreements similar to those that are called for in S.2544

Yet, the International Securities Enforcement Act is a step in the right direction. I look forward to the discussion with SEC Chairman David Ruder, as well as the questioning of our other guests. I again complement Senators Riegle, Proxmire, and Garn for such a fine bill and I yield the rest of my time back to the chair.

STATEMENT OF SENATOR JAKE GARN

JUNE 29, 1988

I AM PLEASED TO HAVE CO-SPONSORED S. 2544, THE INTERNATIONAL SECURITIES ENFORCEMENT COOPERATION ACT OF 1988, AND COMMEND YOU, MR. CHAIRMAN, ON YOUR LEADERSHIP IN BRINGING THIS LEGISLATION TO THE COMMITTEE AND SCHEDULING THIS HEARING IN SUCH A PROMPT FASHION. THIS KIND OF LEGISLATION IS IMPORTANT AND TIMELY AND IT IS MY HOPE THAT WE CAN PROCEED EXPEDITIOUSLY TO A FULL HEARING AND DEBATE ON THE SPECIFICS OF THE BILL.

MR. CHAIRMAN, AS WE HAVE HEARD THIS MORNING, THE SECURITIES MARKETS ARE BECOMING INCREASINGLY INTERNATIONALIZED. THIS PROCESS, WHICH IS CERTAINLY BENEFICIAL, ENHANCES THE DEPTH AND LIQUIDITY OF TRADING MARKETS AND PROVIDES NEW SOURCES OF CAPITAL. HOWEVER, IT HAS ALSO CREATED NEW OPPORTUNITIES FOR PERSONS TO ENGAGE IN FRAUDULENT AND ILLEGAL ACTIVITY TO THE DETRIMENT OF INVESTORS. WE MUST TAKE CARE TO ENSURE THAT THE RAPID GROWTH AND DEVELOPMENT IN INTERNATIONAL MARKETS DOES NOT EXCEED OUR CAPABILITY TO ADEQUATELY SUPERVISE THEM.

THAT THIS IS A PRESENT PROBLEM IS AMPLY DEMONSTRATED BY THE CHARGES FILED EARLIER THIS WEEK BY THE SEC AGAINST TWO INDIVIDUALS, ONE A FOREIGN INVESTOR, FOR INSIDER TRADING. THESE ALLEGATIONS REPRESENT THE SECOND LARGEST INSIDER TRADING CASE EVER. FOR THE PROTECTION OF INVESTORS AND INTEGRITY OF OUR MARKETPLACES, WE CAN ILL AFFORD TO LEAVE THE IMPRESSION THAT A SECURITIES LAW VIOLATOR CAN ESCAPE VIGOROUS PROSECUTION BY ENGAGING IN HIS OR HER CONDUCT FROM ABROAD OR THROUGH FOREIGN ENTITIES. S. 2544 COULD PROVIDE SOME USEFUL TOOLS TO THE SEC TO SEE THAT THIS DOESN'T HAPPEN.

STATEMENT OF SENATOR D'AMATO ON S.2544 THE INTERNATIONAL SECURITIES ENFORCEMENT AND COOPERATION ACT OF 1988

I WOULD LIKE TO COMMEND MY COLLEAGUE FROM MICHIGAN FOR TAKING THE LEAD IN THIS EFFORT. I WOULD ALSO COMMEND THE SECURITIES EXCHANGE COMMISSION FOR ITS EFFORTS TO STREAMLINE ITS MEANS OF ENFORCING THE SECURITIES LAWS IN THE INCREASINGLY INTERNATIONAL MARKET IN SECURITIES. I WHOLE-HEARTEDLY SUPPORT THE SEC'S EFFORTS TO EXTEND VIGOROUS ENFORCEMENT OF OUR SECURITIES LAWS INTO THE INTERNATIONAL MARKETPLACE. I ALSO COMMEND THE EFFORTS OF THE S.E.C. TO DISCOVER EVIDENCE OF SUCH VIOLATIONS WHICH MAY BE CLEVERLY HIDDEN IN FOREIGN JURISDICTIONS. CLEARLY, FINANCIAL SECRECY LAWS IN FOREIGN JURISDICTIONS PROVIDE EXCELLENT AND FORTUITOUS COVER FOR THOSE WHO WOULD GREEDILY COMPROMISE THE INTEGRITY OF SECURITIES MARKETS IN VIOLATION OF U.S. LAWS.

INCREASING INTERNATIONALIZATION OF THE SECURITIES MARKETPLACE SURELY CREATES UNPRECEDENTED CHALLENGES FOR THE COMMISSION AND OTHER REGULATORY AND ENFORCEMENT AGENCIES BOTH DOMESTIC AND FOREIGN. I SEE THE INTRODUCTION OF THIS BILL

AND THIS HEARING AS POSITIVE STEPS FORWARD IN PROMOTING FAIR AND EFFECTIVE ENFORCEMENT OF UNITED STATES SECURITIES LAWS.

AS WE PROCEED TOWARD THAT GOAL WE SHOULD GIVE THE S.E.C. NOT ONLY THE AUTHORITY TO COOPERATE WITH FOREIGN AGENCIES BUT SOME LEVERAGE IN ITS NEGOTIATIONS WITH FOREIGN AGENCIES. AS THE DISTINGUISHED CHAIRMAN NOTED IN HIS REMARKS INTRODUCING THIS BILL, COOPERATION IS THE MOST EFFECTIVE MEANS TO DETER AND APPREHEND VIOLATIONS OF OUR SECURITIES LAWS. HOWEVER, AS THE CHAIRMAN ALSO NOTED, NOT EVERY FOREIGN AUTHORITY HAS BEEN WILLING TO COOPERATE. THEREFORE, I AM PARTICULARLY ANXIOUS TO HEAR THE TESTIMONY OF OUR DISTINGUISHED WITNESSES ON THE SUBJECT OF THE WAY THIS BILL WILL PROMOTE COOPERATION BY FOREIGN GOVERNMENTS IN OUR LAW ENFORCEMENT EFFORTS. I WOULD ALSO LIKE TO HEAR ABOUT ANY METHODS NOT ADDRESSED IN THIS BILL WHICH WOULD ASSIST THE COMMISSION IS GAINING THE COOPERATION OF SECRETIVE FOREIGN COUNTRIES.

THIS BILL ALSO STRENGTHENS THE AUTHORITY OF THE COMMISSION TO DISCIPLINE SECURITIES PROFESSIONALS WITH ITS JURISDICTION FOR VIOLATION OF FOREIGN LAWS. I HOPE THAT CHAIRMAN RUDER WILL BE ABLE TO GIVE US SOME THOUGHTS ON THE PARAMETERS WITHIN WHICH THIS AUTHORITY MIGHT BE EXERCIZED. BY ALL MEANS, I SUPPORT EFFECTIVE DISCIPLINE OF SECURITIES PROFESSIONALS WHOSE CONDUCT FALLS BELOW APPROPRIATE STANDARD. AND I WOULD ONLY CAUTION MY COLLEAGUES THAT WE MUST BE FULLY INFORMED AS TO THE TYPES OF FOREIGN LAW

VIOLATIONS THAT MIGHT SUPPORT DISCIPLINARY ACTION BY THE S.E.C.

AGAIN, LET ME COMMEND THIS EFFORT AND ASSURE THE SPONSORS OF MY SUPPORT OF THEIR EFFORT.

II

100TH CONGRESS
2D SESSION

S. 2544

To amend the Federal securities laws in order to facilitate cooperation between the United States and foreign countries in securities law enforcement.

IN THE SENATE OF THE UNITED STATES

JUNE 21 (legislative day, JUNE 20), 1988

Mr. RIEGLE (for himself, Mr. PROXMIRE, Mr. GARN, and Mr. DODD) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Federal securities laws in order to facilitate cooperation between the United States and foreign countries in securities law enforcement.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "International Securities Enforcement Cooperation Act of 1988".

SEC. 2. TABLE OF CONTENTS.

The contents of this Act are as follows:

Sec. 1. Short title.
Sec. 2. Table of contents.

TITLE I—ASSISTANCE TO FOREIGN SECURITIES AUTHORITIES

Sec. 101. Investigatory Assistance to Foreign Securities Authorities.
Sec. 102. Release of Records by the Commission.

TITLE II—MISCONDUCT BY SECURITIES PROFESSIONAL IN FOREIGN COUNTRY AS BASIS FOR RESTRICTING PROFESSIONAL'S ACTIVITIES IN THE UNITED STATES SECURITIES INDUSTRY

Sec. 201. Sanctions Against Broker or Dealer, Associated Person, or Persons Seeking Association.
Sec. 202. Definition of Foreign Financial Regulatory Authority.
Sec. 203. Conforming Amendments to the Securities Exchange Act of 1934.
Sec. 204. Sanctions Against Investment Advisers or Persons Associated or Seeking Association with a Registered Investment Adviser or Investment Company.
Sec. 205. Definitions of Foreign Securities Authority and Foreign Financial Regulatory Authority.

TITLE I—ASSISTANCE TO FOREIGN SECURITIES AUTHORITIES

SEC. 101. INVESTIGATORY ASSISTANCE TO FOREIGN SECURITIES AUTHORITIES.

Title I of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(a) by adding after and below section 3(a) the following:

"(50) The term 'foreign securities authority' means any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters.";

(b) by redesignating subsection 21(a) as subsection 21(a)(1); and

(c) by adding after and below subsection 21(a)(1) the following:

"(2) On request from a foreign securities authority, the Commission may, in its discretion, provide assistance in accordance with this paragraph if the requesting authority states: (a) that it is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that it administers or enforces and (b) agrees to provide similar assistance to the Commission in securities matters. The Commission may conduct such investigation as it deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States. In deciding whether to provide such assistance, the Commission shall consider whether compliance with the request would prejudice the public interest of the United States.".

SEC. 102. RELEASE OF RECORDS BY THE COMMISSION.

Section 24 of the Securities Exchange Act of 1934 (15 U.S.C. 78x) is amended—

(a) by striking from subsection 24(b) "Nothing in this subsection shall authorize the Commission to withhold information from the Congress.";

(b) by adding after and below subsection 24(b) the following:

"(c) Notwithstanding any other provision of law, the Commission may, in its discretion and upon a showing that

such information is needed, provide all 'records' (as defined in subsection (a) above) and other information in its possession to such persons, both domestic and foreign, as the Commission by rule deems appropriate: *Provided*, That the person receiving such records or information provides such assurances of confidentiality as the Commission deems appropriate: *And provided further*, That nothing in this section shall alter the Commission's responsibilities under the Right to Financial Privacy Act, section 3401 of title 12, United States Code, et seq., as limited by section 21(h) of the Securities Exchange Act, section 78u(h) of title 15, United States Code, with respect to transfers of records covered by such statutes.

"(d) Notwithstanding the provisions of the Freedom of Information Act, section 551 of title 5, United States Code, et seq., or of any other law, the Commission shall not be compelled to disclose records obtained from a foreign securities authority if the foreign securities authority has in good faith represented to the Commission that public disclosure of such records would be contrary to the laws of the foreign country from which they were obtained;

"(e) Nothing in this section shall prevent the Commission from complying with a request for information from the Congress or from complying with an order of a court of the

United States in an action commenced by the United States or the Commission.".

TITLE II—FOREIGN MISCONDUCT BY SECURITIES PROFESSIONAL IN FOREIGN COUNTRY AS BASIS FOR RESTRICTING PROFESSIONAL'S ACTIVITIES IN THE UNITED STATES SECURITIES INDUSTRY

SEC. 201. SANCTIONS AGAINST BROKER OR DEALER, ASSOCIATED PERSONS, OR PERSONS SEEKING ASSOCIATION.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended as follows:

(a) Subsection 15(b) (15 U.S.C. 78o) is amended—

(1) by inserting in subparagraph 15(b)(4)(B) after "misdemeanor" the following: "or has been convicted within ten years of a substantially equivalent crime by a foreign court of competent jurisdiction";

(2) by inserting in subparagraph 15(b)(4)(B)(i) after "burglary," the following: "any substantially equivalent activity however denominated by the laws of the relevant foreign government";

(3) by inserting in subparagraph 15(b)(4)(B)(ii)

(A) after "transfer agent," the following: "foreign person performing a function substantially equivalent to any of the above,";

(B) after "(7 U.S.C. 1 et seq.)" the following: "or any equivalent foreign statute or regulation";

(4) by inserting in subparagraph 15(b)(4)(B)(iii) after "securities," the following: "or substantially equivalent activity however denominated by the laws of the relevant foreign government,";

(5) by inserting in subparagraph 15(b)(4)(B)(iv) after "United States Code" the following: ", or a violation of a substantially equivalent foreign statute.";

(6) by inserting in subparagraph 15(b)(4)(C)—

(A) after "transfer agent," "foreign person performing a function substantially equivalent to any of the above,";

(B) after "Commodity Exchange Act" each time it appears, "or any substantially equivalent foreign statute or regulation"; and

(C) after "insurance company," "foreign entity substantially equivalent to any of the above,"; and

(7) by adding after and below subparagraph 15(b)(4)(F) the following:

"(G) has been found by a foreign financial regulatory authority to have—

"(i) made or caused to be made in any application for registration or report required to be filed with a foreign financial regulatory authority, or in any proceeding before a foreign financial regulatory authority with respect to registration, any statement that was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any application or report to the foreign financial regulatory authority any material fact that is required to be stated therein;

"(ii) violated any foreign statute or regulation regarding transactions in securities, or contracts of sale of a commodity for future delivery, traded on or subject to the rules of a contract market or any board of trade;

"(iii) aided, abetted, counseled, commanded, induced, or procured the violation by any person of any provision of any statutory provisions enacted by a foreign government, or rules or regulations thereunder, empowering a foreign financial regulatory authority regarding transactions in securities, or contracts of sale of a commodity for future delivery, traded on or subject to the rules

of a contract market or any board of trade, or has been found, by a foreign financial regulatory authority, to have failed reasonably to supervise, with a view to preventing violations of such statutory provisions, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision.".

(b) Subsection 15(b)(6) is amended by striking out "(A), (D), or (E)" and inserting in lieu thereof "(A), (D), (E), or (G)".

(c) Subparagraph 3(a)(39)(A) is amended by inserting—

(1) after "self-regulatory organization," the following "foreign equivalent, foreign or international securities exchange,"; and

(2) after both "(7 U.S.C. 7)" and "(7 U.S.C. 21)", the following: "or any substantially equivalent foreign statute or regulation,";

(3) after "contract market", the following: "or foreign equivalent";

(d) Subparagraph 3(a)(39)(B) is amended by striking out "or" after "Commission" and after "government securities broker," each time it appears, by inserting a comma after "Commission", and by inserting—

(1) after "appropriate regulatory agency," the following: ", or foreign financial regulatory authority";

(2) after "government securities dealer" the first time it appears, the following: "or limiting his activities as a foreign person performing a function substantially equivalent to any of the above";

(3) after "government securities dealer" the second time it appears, the following: ", or foreign person performing a function substantially equivalent to any of the above;

(4) after "(7 U.S.C. 1 et seq.)" a comma in lieu of the semicolon, and thereafter the following: "or is subject to an order by a foreign regulatory authority denying, suspending, or revoking the person's authority to engage in transactions in contracts of sale of a commodity for future delivery or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent thereof;".

(e) New subparagraph 3(a)(39)(D) is added by inserting after and below subparagraph 3(a)(39)(C) the following:

"(D) by his conduct while associated with any broker, dealer, municipal securities dealer, government securities broker, government securities dealer, or any other entity engaged in transactions in securities, or while associated with an entity engaged in transactions in contracts of sale of a commodity for future delivery or other instruments traded on or subject to the rules

of a contract market, board of trade, or foreign equivalent thereof, has been found to be a cause of any effective suspension, expulsion, or order by a foreign or international securities exchange or foreign financial regulatory authority empowered by a foreign government to administer or enforce its laws relating to financial transactions as described in subparagraph (A) or (B) of this paragraph;".

(f) Subparagraphs 3(a)(39)(D) and 3(a)(39)(E) are redesignated as 3(a)(39)(E) and 3(a)(39)(F), respectively.

(g) The subparagraph redesignated as 3(a)(39)(E) by this section is amended by striking out "(A), (B), or (C)" and inserting in lieu thereof "(A), (B), (C), or (D)".

(h) The subparagraph redesignated as 3(a)(39)(F) by this section is amended by striking out "(D) and (E)" and inserting in lieu thereof "(D), (E), or (G)".

SEC. 202. DEFINITION OF FOREIGN FINANCIAL REGULATORY AUTHORITY.

Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding after and below subsection 3(a)(50) the following:

"(51) The term 'foreign financial regulatory authority' means any (1) foreign securities authority, (2) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent, or other financial activities, or (3) membership organization a function of which is to regulate participation of its members in activities listed above.".

SEC. 203. CONFORMING AMENDMENTS.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by striking out "(A), (D), or (E)" in subsections 15B(c)(2) and 15B(c)(4) and in subparagraphs 15C(c)(1)(A), 15(C)(c)(1)(C), 17A(c)(3)(A), and 17A(c)(3)(C) and inserting in lieu thereof "(A), (D), (E), or (G)" and in subsection 15C(f)(2) by striking out "or the rules or regulations under any such other provision" and inserting in lieu thereof "the rules or regulations under any such other provision, or investigations pursuant to section 21(a)(2) of this title to assist a foreign securities authority".

SEC. 204. SANCTIONS AGAINST INVESTMENT ADVISERS OR PERSONS ASSOCIATED OR SEEKING ASSOCIATION WITH A REGISTERED INVESTMENT ADVISER OR INVESTMENT COMPANY.

(a) Section 9(b) of the Investment Company Act of 1940 (15 U.S.C. 80a–9(b)) is amended by adding after and below subsection 9(b)(3) the following new subsections:

"(4) has been found by a foreign financial regulatory authority to have—

"(A) made or caused to be made in any application for registration or report required to be filed with a foreign securities authority, or in any proceeding before a foreign securities authority with respect to registration, any statement that was at the time and in light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any application or report to a foreign securities authority any material fact that is required to be stated therein;

"(B) violated any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade;

"(C) aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade, "(5) within ten years has been convicted by a foreign court of competent jurisdiction of a crime, however denominated by the laws of the relevant foreign government, that is substantially equivalent to an offense set forth in paragraph (1) of subsection (a); or

"(6) by reason of any misconduct, is temporarily or permanently enjoined by any foreign court of competent jurisdiction from acting in any of the capacities, set forth in paragraph (2) of subsection (a), or a substantially equivalent foreign capacity, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security.".

(b) Section 203(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(e)) is amended by inserting—

(1) in subsection 203(e)(2) after "misdemeanor" the following: "or has been convicted within ten years of a substantially equivalent crime by a foreign court of competent jurisdiction";

(2) in subparagraph 203(e)(2)(A) after "burglary," the following: "any substantially equivalent activity however denominated by the laws of the relevant foreign government,";

(3) in both subparagraph 203(e)(2)(B) and subsection 203(e)(3) after "transfer agent" the following:

"foreign person performing a function substantially equivalent to any of the above,"; and after "Commodity Exchange Act" each time it appears, the following: "or any substantially equivalent statute or regulation";

(4) in subparagraph 203(e)(2)(C) after "securities" the following: "or substantially equivalent activity however denominated by the laws of the relevant foreign government";

(5) in subparagraph 203(e)(2)(D) after "United States Code" the following: ", or a violation of a substantially equivalent foreign statute";

(6) in subsection 203(e)(3) after "court of competent jurisdiction" the following: ", including any foreign court of competent jurisdiction" and after "insurance company" the following: "foreign entity substantially equivalent to any of the above";

(7) in subsection 203(e)(5) after "this title" the following: "the Commodity Exchange Act,";

(8) after and below subsection 203(e)(6) the following new subsection:

"(7) has been found by a foreign financial regulatory authority to have—

"(A) made or caused to be made in any application for registration or report required to be filed with a foreign securities authority, or in any proceeding before a foreign securities authority with respect to registration, any statement that was at the time and in light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any application or report to a foreign securities authority any material fact that is required to be stated therein;

"(B) violated any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade;

"(C) aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade, or has been found, by the foreign financial regulatory authority, to have failed reasonably to supervise, with a view to preventing violations of statutory provisions, and rules and regulations promulgated thereunder, another

person who commits such a violaton, if such other person is subject to his supervision.".

(c) Section 203(f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(f)) is amended by striking out "paragraph (1), (4), or (5)" and inserting in lieu thereof "paragraph (1), (4), (5), or (7)".

SEC. 206. DEFINITIONS OF FOREIGN SECURITIES AUTHORITY AND FOREIGN FINANCIAL REGULATORY AUTHORITY

(a) Section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)) is amended by adding after and below subsection 2(a)(48) the following new subsections:

"(49) 'foreign securities authority' means any foreign government or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters.

"(50) 'foreign financial regulatory authority' means any (1) foreign securities authority, (2) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for membership organization a function of which is to regulate participation of its members in activities listed above.”.

○

Senator **Riegle**. I thank the Senator from Alabama and we will make his statement a part of the record.

Let me just make some opening remarks here to set the stage for the testimony of our witnesses.

This morning we are going to hear from the SEC Chairman, David Ruder, as well as a representative from the State Department on behalf of S. 2544, the International Securities Enforcement Cooperation Act.

I have introduced this legislation, together with Senators Proxmire, Garn, Dodd, and Wirth, in order to facilitate cooperation between the United States and foreign countries in securities law enforcement.

With the active support of the Commission and the administration, I believe we can pass this legislation this year. I think the SEC is to be especially commended for its work on S. 2544.

The legislation is particularly timely in light of the rampant insider trading securities law violations that are taking place internationally. Earlier this week, the SEC brought the second largest insider trading case ever. This latest scandal involving a Taiwanese businessman, Fred C. Lee, and a 24-year-old Morgan Stanley employee, Steven Wang, Jr., clearly demonstrates the need for ongoing and increased cooperation between securities enforcement regulators worldwide, and I look forward to Chairman Ruder discussing with us today what cooperation, if any, took place between the U.S. Securities and Exchange Commission and any of its counterparts in this matter.

With the rapid internationalization of the capital markets have come significantly expanded opportunities for legitimate investment activities, but it also has provided new means for persons to engage in fraud. The *Dennis Levine* case is a prime example. In that case, Mr. Levine purchased and sold securities based on confidential information that had been stolen from his investment banking clients. He sought to conceal this insider trading by executing transactions through a secret bank account in the Bahamas. Mr. Levine ultimately was apprehended because SEC officials persuaded the Bahamian Attorney General that his country's secrecy law should not obstruct the Commission's investigation.

But not all foreign authorities have been as willing to cooperate with the SEC as was the case with the Bahamian Attorney General.

Our legislation addresses that problem by facilitating international cooperation between securities law regulators. It recognizes that such cooperation is the most efficient and effective way to deter and apprehend insider traders and law violators.

The bill would amend the Securities and Exchange Act of 1934 to provide that the SEC at the request of its counterpart in a foreign country may require persons or entities located in this country to produce evidence relating to a potential violation of the foreign country's securities laws. The foreign counterpart must agree to provide the Commission with similar investigative assistance. So it is a reciprocal arrangement.

At the present time, the SEC lacks such authority and can compel the production of documents in evidence only when it appears that a violation of the U.S. securities laws may have occurred.

The bill contains other provisions. I will not state them now, but they will be part of the remainder of my statement which I'm going to have printed in the record at this point.

[Committee insert of Senator Riegle's complete statement:]

OPENING STATEMENT OF DONALD W. RIEGLE, JR.

JUNE 29, 1988 - 10:00 a.m.

HEARING ON S. 2544 - THE INTERNATIONAL SECURITIES ENFORCEMENT COOPERATION ACT OF 1988

This morning we will hear from SEC Chairman David Ruder as well as a representative from the State Department on S. 2544 the International Securities Enforcement Cooperation Act. I introduced this legislation together with Senators Proxmire, Garn, Dodd and Wirth in order to facilitate cooperation between the United States and foreign countries in securities law enforcement. With the active support of the Commission and the Administration I believe we can pass this legislation this year. The SEC is to be especially commended for its work on S. 2544.

This legislation is particularly timely in light of the rampant insider trading and securities laws violations that are taking place internationally. Earlier this week the SEC brought the second largest insider trading case ever. This latest scandal involving a Taiwanese businessman, Fred C. Lee and a 24 year old Morgan Stanley employee Stephen Wang, Jr. clearly demonstrates the need for ongoing and increased cooperation between securities enforcement regulators worldwide. I look forward to Chairman Ruder discussing with us today what cooperation, if any, took place between the United States Securities and Exchange Commission and any of its counterparts in this matter.

While the rapid internationalization of the capital markets has significantly expanded opportunities for legitimate investment activities it has also provided new means for persons to engage in fraud. The Dennis Levine case is a prime example. Mr. Levine purchased and sold securities based on confidential information that he had stolen from his investment banking clients. He sought to conceal this illegal insider trading by executing transactions through a secret bank account in the Bahamas. Mr. Levine ultimately was apprehended because SEC officials persuaded the Bahamian Attorney General that his country's secrecy laws should not obstruct the Commission's investigation. But not all foreign authorities have been as willing to cooperate with the SEC as was the Bahamian Attorney General.

Our legislation addresses that problem by facilitating international cooperation between securities law regulators. It recognizes that such cooperation is the most efficient and effective way to deter and apprehend insider traders and other law violators.

The bill would amend the Securities Exchange Act of 1934 to provide that the SEC, at the request of its counterpart in a foreign country, may require persons or entities located in this country to produce evidence relating to a potential violation of the foreign country's securities laws. The foreign counterpart must agree to provide the Commission with similar investigative assistance. At the present time, the SEC lacks such authority, and can compel the production of documents and evidence only when it appears that a violation of the U.S. securities laws may have occurred.

The legislation also contains three other provisions relating to international securities enforcement. First, the bill would amend the 1934 Act to enable the SEC to maintain the confidentiality of certain foreign evidence.

Second, the bill would make explicit the SEC's rulemaking authority to provide documents and other information to foreign authorities.

And, finally the bill would provide the SEC with the authority to censure, revoke the registration of, or impose employment restrictions upon a securities professional who is found by a foreign court or foreign securities authority to have engaged in illegal or improper conduct. The SEC has such authority as to findings of illegal or improper activity in this country, but its authority as to improper activity abroad is limited. I believe that the United States should not become a haven for securities professionals who violate foreign laws.

In conclusion, we must recognize that the capital markets of the world have become increasingly interrelated. The integrity and efficiency of these markets must be preserved and investors worldwide must have confidence in them. The recent flood of securities laws violations with international implications makes greater cooperation between enforcement agencies essential. S. 2544 is a step in the direction of ensuring that cooperation and I look forward to the views of our witnesses on this subject this morning.

Senator RIEGLE. So with that, Chairman Ruder, we're pleased to have you here. Let me just say at the outset that I know these have been particularly turbulent times at the SEC and in our world capital markets, and I want to say again, as I've said previously, that I appreciate your leadership, and your active efforts to guide the Commission. I know there have been a number of matters that were there prior to your arrival and that you've attempted to work with, but the subcommittee and the full committee appreciate the effort that you're giving, the leadership you're giving, and we're pleased to have you here today.

STATEMENT OF DAVID S. RUDER, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION; ACCOMPANIED BY GARY LYNCH, DIRECTOR, ENFORCEMENT DIVISION, SEC

Mr. RUDER. Chairman Riegle, thank you for those comments.

Chairman Riegle and members of the subcommittee, I thank you for this opportunity to testify about the International Securities Enforcement Cooperation Act of 1988. This bill which is substantially similar to legislation proposed by the Securities and Exchange Commission would provide the Commission with important tools to deal with enforcement problems arising from the internationalization of securities markets.

I have submitted written testimony which I ask to be included in the record.

Senator RIEGLE. It will be made a part of the record.

INCREASE OF FOREIGN PARTICIPATION IN THE SECURITIES MARKETS

Mr. RUDER. Foreign participation in the securities markets has increased dramatically in the past years. For example, the dollar volume of U.S. equity securities purchased and sold by persons from foreign countries grew from $25 billion in 1977 to $481 billion in 1987.

Internationalization of the securities markets has many desirable effects, such as facilitating the raising of capital by private corporations and governments, but growing foreign participation and increased cross-border trading activity also have expanded opportunities for fraud. Dishonest persons have in a growing number of cases sought to hide behind foreign secrecy or blocking laws in order to carry out their frauds. Suspicious transactions on the U.S. securities markets through foreign financial institutions are generally more difficult for the Commission to investigate than are purely domestic transactions. In cases where the institution is operating in a jurisdiction that has bank secrecy or blocking laws, the institution sometimes is not able legally to disclose information voluntarily relating to the customer's account or identity. As a result, rather than being able to obtain information directly through its subpoena power, the Commission must then proceed through authorities in other countries.

In most such investigations, the Commission also will want to obtain information from parties other than the trading institution. For example, hotel or telephone records often provide valuable circumstantial evidence in securities fraud cases. Again, to the extent relevant documents are located outside the United States, the Commission's subpoena power is ineffective.

Because of these obstacles, the Commission has aggressively pursued negotiations of memoranda of understanding—we call them MOU's—with foreign authorities. Under these bilateral agreements, the Commission and its foreign counterparts would agree to assist each other in obtaining evidence in securities fraud investigations. Such agreements have been reached with Switzerland and the relevant authorities in the United Kingdom, Japan, and three Canadian Provinces.

These agreements are particularly helpful in an ever increasing number of the Commission's investigations. The assistance under these agreements, however, is generally limited to that which the authorities can provide using their "best efforts." There are statutory limitations on these efforts.

For instance, in the United States, the Commission often may make information already in its possession available to a foreign securities authority, but unless a separate Commission action is underway the Commission cannot compel a witness to testify or to produce documents such as telephone or bank records. The Commission does not have legal authority to use its subpoena powers in the United States to assist foreign authorities when the Commission has not begun its own investigation and it may have no grounds to begin one.

USING FOREIGN JURISDICTION

The reverse is also true. The Commission may want a foreign jurisdiction to assist it in gathering evidence for the Commission by using the foreign jurisdiction's compulsory power even if that jurisdiction has no investigation underway.

To enhance the effectiveness of MOU's, the Commission believes that each country should provide for the use of compulsory process to provide investigative assistance to aid in investigations by its foreign counterparts. Our past experience indicates that attempts by the Commission to utilize its United States subpoena power overseas will meet serious resistance. International cooperation in the securities field is the best solution and this cooperation can best be facilitated if the Commission and its foreign counterparts obtain the necessary authority to make investigative assistance a two-way street.

The Commission's MOU with the Canadian Provinces anticipates the availability of compulsory investigative authority of the type we seek. In these agreements each jurisdiction has agreed to utilize its subpoena power on behalf of the other and to seek such authority if it does not now exist. If the proposed legislation is enacted, the Commission will be in a better position to negotiate agreements with other countries similar to the Canadian MOU.

It is important to note that the proposed legislation would not require the Commission to conduct an investigation at the request of a foreign authority. Indeed, the Commission would have complete discretion to refuse assistance. Further, when the Commission agrees to investigate at a foreign authority's request, the Commission will utilize established procedures thereby providing witnesses with all of the protections and remedies afforded to witnesses in Commission proceedings.

Through these existing procedures, the legislation ensures that the witnesses' due process and fourth amendment rights will be protected.

The only portion of the proposed legislation which the Commission believes should be changed is the requirement that another country agree to provide similar assistance before the Commission can exercise the powers authorized by the bill to assist that foreign country.

This requirement could restrict the Commission's ability to provide assistance in cases where such assistance would be in the interest of both foreign and U.S. investors. For this reason, we would propose deleting the requirement for similar assistance requiring instead that the Commission in deciding whether to grant assistance consider whether the requesting authority has agreed to provide the Commission with reciprocal assistance.

INTERNATIONAL SECURITIES ENFORCEMENT

The legislation includes three other provisions relating to international securities enforcement.

First, the bill would enable the Commission to maintain the confidentiality of certain documents furnished to the Commission by foreign securities authorities. Under the Freedom of Information Act, which I will refer to as FOIA, the Commission generally must make available to the public nonexempt documents it has in its files. In contrast, many foreign countries have strict confidentiality requirements as to certain documents. Not surprisingly, foreign securities officials have, out of concern about FOIA, sometimes refused to provide the Commission with documents required to be kept confidential under the relevant foreign law. Thus, in order to facilitate the Commission's ability to obtain otherwise unobtainable information which is confidential from foreign countries for law enforcement purposes, I believe it is necessary to carve out an exception to FOIA.

The legislation would provide the Commission with the authority not to release records obtained from a foreign securities authority when that authority represents that such public disclosure would violate its country's laws.

A second provision in the legislation would clarify the Commission's rulemaking power to establish procedures whereby documents and other information may be provided to foreign authorities as well as to other domestic law enforcement officials.

Pursuant to MOU's and informal arrangements, the Commission has made documents in its files available to foreign officials for many years. We also routinely grant access requests from the Department of Justice, state securities commissions, and other enforcement agencies.

Despite these long-standing practices, the securities laws contain no express authority for such grants of access. Accordingly, to preempt any argument that such access grants are not permissible, we believe the adoption of the proposed legislation presents the most prudent course.

Finally, the bill would provide the Commission with the authority to censure, revoke the registration of, or impose employment restrictions on a securities professional who is found by a foreign court or foreign securities authority to have engaged in illegal or improper conduct.

AUTHORITY TO IMPROPER ACTIVITY ABROAD IS LIMITED

The Commission has such authority as to findings of illegal or improper activity in this country, but its authority as to improper activity abroad is limited. The legislation would provide the Commission with the discretionary authority to impose sanctions on securities professionals who have been found to have engaged in misconduct abroad when, had the same misconduct taken place in the United States, the professional would have been subject to Commission administrative proceedings to impose sanctions.

This authority is important because our markets should not be open to securities professionals who have been found to have violated foreign laws. As foreign securities authorities become more active in bringing cases against dishonest brokers and other professionals, this power will become increasingly necessary.

I believe the proposed amendments are a measured response to a growing problem. If the Commission is unable to enforce the federal securities laws against persons operating in an international context, then the U.S. markets would unquestionably be less fair and honest.

I therefore recommend enactment of these amendments at the earliest possible time. Thank you.

[The complete prepared statement of Mr. Ruder follows:]

and (b) of the Investment Company Act. Certain subsections of these provisions also have been used to support the imposition of limitations on activities of securities professionals based upon the findings of a foreign court as to illegal activity abroad. In conjunction with the amendments contained in Title I, the Commission believes that it would be appropriate to make this explicit and add to the Commission's existing authority.

The Commission believes that it should have the foregoing authority to suspend or bar securities professionals who have made false filings with foreign authorities; who have been convicted of certain crimes (both securities and non-securities related) by foreign courts; who have been enjoined by a foreign court from committing securities law violations; who have violated foreign securities laws; or who have aided and abetted such violations. The Commission believes that this authority is a necessary supplement to its authority to place limitations on securities professionals based on violations of U.S. laws. Moreover, these legislative changes reflect the Commission's belief that, at least in part as a result of the enforcement assistance that the Commission will provide to foreign authorities pursuant to Section 101 of this bill, securities professionals will be subject to more aggressive enforcement efforts by such foreign authorities. It would be ironic if securities professionals who are found, with the Commission's assistance under Section 101, to have violated foreign securities laws, were allowed unfettered operations in the U.S. securities markets, even though limitations would have been placed on them for the same violations in the U.S. The proposed legislation would protect against such a result.

The Commission believes that we have made great progress in developing mechanisms and approaches for policing the internationalized U.S. markets. The International Securities Enforcement and Cooperation Act of 1988 provides the authority necessary to build on this progress. Enactment of the legislation would provide a critical vehicle for enhancing our efforts to maintain the integrity of the U.S. securities markets.

I. INTERNATIONAL PARTICIPATION IN THE U.S. SECURITIES MARKETS

As the table below indicates, foreign purchases and sales of U.S. equity securities have grown dramatically during the past ten years. The dollar volume of U.S. equity securities purchased and sold from abroad increased from $25.6 billion in 1977 to $481.5 billion in 1987. For a general contrast, the total trading volume on U.S. markets increased from about $198 billion in 1977 to about $2,492 billion in 1987.

Foreign Activity in U.S. Corporate Stock
1977-1987
(U.S. $ Millions)

Year	Purchases	Sales	Net Capital Flows
1977	$ 14,154	$ 11,479	$ 2,675
1978	20,145	17,723	2,422
1979	22,783	21,104	1,679
1980	40,298	34,870	5,428
1981	40,686	34,856	5,830
1982	41,881	37,981	3,900
1983	69,770	64,360	5,410
1984	59,834	62,814	-2,980
1985	81,995	77,054	4,941
1986	148,114	129,395	18,719
1987(p)	$248,886	$232,614	$ 16,273

p = preliminary

Source: U.S. Treasury Bulletin (various issues)

II. COMMISSION INITIATIVES FOR EXCHANGING AND OBTAINING INFORMATION

A. The Commission's Memoranda of Understanding

1. Overview

Through its formal and informal contacts with other countries and its participation in several international organizations addressing issues relating to the globalization of the markets, the Commission is actively seeking greater cooperation, and where possible, the negotiation of mutual assistance agreements, with foreign countries. The Commission has focused on, and generally is working with, the countries with which it has had contact both as a result of enforcement investigations and in the market regulation context. Further, as new needs and opportunities arise, the Commission attempts

First, the Commission has relied on unofficial channels of communication with foreign law enforcement authorities to obtain necessary information through cooperative means. In In the Matter of Guaranty Trust Co. Ltd., Supreme Court of the Bahamas No. 423 (May 22, 1985), the Commission sought a court order requiring the production of evidence relating to the identity of customers of a Bahamian bank who had purchased securities just prior to a merger announcement. The Commission argued that a securities transaction was not a banking transaction pursuant to Bahamian law and, therefore, Bahamian secrecy laws should not apply to shield the customers' identities. The Commission pursued this approach with the support of the Bahamian Attorney General. However, because the matter involved an investigation and not a litigation, the Bahamian court ruled that the Commission had no standing to utilize the court's powers. While this result frustrated the Commission's investigation of the matter, this case laid the groundwork for the positive result achieved in SEC v. Levine, 86 Civ. 3276 (S.D.N.Y.). In the investigation preceeding the filing of that action, the Bahamian Attorney General, recognizing that court action in the Bahamas was not possible, gave assurances to the bank involved that the securities transactions effected through it were not banking transactions and therefore it could cooperate without fear of prosecution in the Bahamas. As a result, the Commission obtained account information from Levine's Bahamian bank, which identified him as the beneficial owner of the subject accounts. This information was critical to the Commission's investigation, and contributed to the Commission's success in its civil injunctive action against Levine and others.

In another matter, SEC v. Musella, 83 Civ 342 (S.D.N.Y.), the Commission was also able to obtain informal assistance from the Commonwealth Secretariat, based in London, which has police authority for all Commonwealth countries. There, the Commission obtained vital telephone records from a Hong Kong hotel which linked an alleged insider trader to his source, an employee of a New York law firm. As a result of the information, the Commission was able to amend its complaint to include specific allegations regarding the insider trading scheme and to obtain a preliminary injunction.

The staff also exchanges information on an informal basis with the police departments of various European countries as well as Interpol, the Royal Canadian Mounted Police, and Scotland Yard. The Commission, absent an MOU, seeks informal assistance, where appropriate, from all countries.

In addition, the Commission has been actively participating in meetings and discussions sponsored by various international organizations. The Commission's participation in these organizations has resulted in a dialogue with foreign

regulatory authorities with respect to specific and general enforcement matters. Furthermore, the Commission's participation in such organizations will improve the environment for negotiating mutual assistance agreements, and will further enhance cooperation among international securities regulators. However, while the Commission can open lines of communication with foreign countries and encourage them to negotiate and enter into mutual assistance agreements, the Commission has no power to compel a foreign country to negotiate or enter into such agreements. As a result, the Commission has made substantial efforts to explain the benefits of, and possibility for such agreements with, as many countries as possible.

In this regard, the Commission has been participating in meetings and discussions sponsored by the International Organization of Securities Commissions ("IOSC"), which was established twelve years ago as the Inter-American Association of Securities Commissions and Similar Organizations. In an effort to facilitate discussion among a broader base of securities regulators, the IOSC has expanded its membership to include regulators from all over the world. The Commission has been an active participant in the IOSC since its inception and currently serves as a member of its Executive Committee.

In November 1986, the Executive Committee of the IOSC adopted a Commission proposal relating to cooperation among securities commissions ("the IOSC Resolution"). The IOSC Resolution provides that, to the extent permitted by law, the parties will provide assistance on a reciprocal basis for obtaining information related to market oversight and protection of each nation's markets against fraudulent securities transactions, and that the parties will designate a contact person who will ensure the timely processing of all requests for assistance.

The IOSC Resolution has been submitted to the membership for consideration. On March 18, 1987, the Commission formally ratified the IOSC Resolution, agreeing to provide assistance on a reciprocal basis to the extent permitted by law to all securities authorities that are members of the IOSC and similarly agree. Twenty-two other members of the IOSC have signed the Resolution: Argentina, Bolivia, Brazil, Chile, Taiwan, Colombia, Costa Rica, Ecuador, France, Great Britain, Hong Kong, Italy, Mexico, New Zealand, Nigeria, Norway, Ontario, Panama, Peru, Quebec, Trinidad and Tobago, and Uruguay.

The Commission's Divisions of Enforcement and Market Regulation also have participated in three meetings sponsored by the United Kingdom Department of Trade and Industry to discuss methods for enhancing the exchange of information among

TESTIMONY OF DAVID S. RUDER
CHAIRMAN OF THE U.S. SECURITIES AND EXCHANGE COMMISSION BEFORE THE SUBCOMMITTEE ON SECURITIES OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

CONCERNING THE INTERNATIONAL SECURITIES ENFORCEMENT AND COOPERATION ACT OF 1988

JUNE 29, 1988

Chairman Riegle and members of the Subcommittee:

The proposed International Securities Enforcement and Cooperation Act of 1988 is an important legislative initiative which will aid in international cooperation to assist and enhance the enforcement of securities laws.

This testimony describes Commission initiatives to obtain cooperation from other countries in the pursuit of evidence concerning suspicious conduct that may violate our securities laws, and our work with international organizations to promote international cooperation in the securities enforcement field. This testimony also explains in detail the Commission's reasons for its strong support for this legislation.

The proposed legislation provides the following:

(1) authority for the Commission to conduct an investigation upon the request of a foreign regulatory authority;

(2) an exemption from statutory disclosure requirements of confidential documents received from foreign authorities;

(3) explicit Commission rulemaking authority to provide nonpublic documents and other information to foreign authorities; and

(4) explicit authority for the Commission to censure, revoke the registration of, or impose employment restrictions upon securities professionals based upon the findings of a foreign court or foreign securities authority.

INTRODUCTION AND SUMMARY

Increasing internationalization is one of the most significant recent developments in the securities markets. The growth of international trading has changed the way in which the securities markets function, and has presented new opportunities -- as well as new challenges -- to market participants and securities regulators. The Commission has undertaken to facilitate the development of international markets in a manner consistent with the investor protection and public interest goals of the U.S. securities laws. This testimony describes the Commission's activities in the enforcement field.

Although increasing internationalization of U.S. markets has expanded opportunities for fraudulent conduct by unscrupulous individuals, the Commission is working to respond to these developments in order to maintain the integrity of the U.S. markets. While encouraging the growth of U.S. markets, the Commission has been mindful of the need to deter and prevent attempts to violate U.S. securities laws and to circumvent procedures for the detection and investigation of such violations.

The central problem that the Commission faces in the enforcement area as a result of internationalization of the markets is the collection of evidence that is located abroad pertaining to violations of the U.S. securities laws. In the past, the vast majority of trading in U.S. markets consisted of transactions by persons or entities located in the U.S. As a consequence, evidence of violations was in most instances located in or controlled from the U.S., and the Commission faced few obstacles in compelling production of that evidence. At present, however, orders are routinely entered in foreign markets for execution in this country, and it may soon be commonplace to execute orders involving several different and overlapping national jurisdictions. As a result of this expansion in international trading, the Commission is increasingly confronted with situations in which all or some of the evidence in an investigation or litigation is located abroad.

Prior to and continuing into the early 1980s, the Commission's efforts to obtain information from abroad were in many instances frustrated and the Commission resorted to the federal courts and unilateral action to compel the production of foreign based information. However, this unilateral approach was time-consuming, expensive, and strained international relations. In part because of its success in U.S. courts, the Commission was able to begin a dialogue with foreign securities authorities and other law enforcement agencies to develop informal case-by-case understandings which facilitated the production of foreign-based information. The *ad hoc* nature of this approach highlighted the need for more formal mechanisms that would provide greater certainty of receiving assistance and foster cooperation. As a result, the Commission began to focus on utilizing existing bilateral and multilateral agreements to satisfy its information needs. In some cases, the Commission found that because these mechanisms were not specifically tailored to Commission investigative and litigation needs, the assistance they made available was less than optimal. Accordingly, the Commission initiated discussions for its own formal agreements or understandings.

As a result, the Commission recently has relied primarily upon the negotiation and implementation of memoranda of understanding ("MOUs") and other agreements with foreign countries to facilitate access to information located abroad. In recent months, the Commission has been actively involved in negotiating new agreements with foreign countries to obtain their cooperation in the Commission's enforcement efforts, and has participated in programs encouraging greater multinational cooperation in securities law enforcement. The Commission's most recent MOU, entered into with the securities commissions of Ontario, Quebec and British Columbia ("the Canadian MOU"), is the most comprehensive to date. The Canadian MOU is unique in providing that the parties will, where necessary, make use of their subpoena authority to obtain information requested by one of the signatories. The Commission, and the Canadian signatories other than Quebec, do not have the statutory authority to conduct an investigation without a showing that a violation of their domestic securities laws may have occurred. Therefore, the Commission has recommended enactment of legislation that would authorize the Commission to conduct investigations on behalf of foreign countries. The International Securities Enforcement and Cooperation Act of 1988, as recently introduced, embodies most of the Commission's proposal.

The recently introduced legislation would amend Section 21(a) of the Securities Exchange Act of 1934 ("Exchange Act") to provide that the Commission "may conduct such investigation as it deems necessary to collect information and evidence pertinent to a request for assistance" by a foreign authority. The Commission believes that the legislation will provide it with an important tool for negotiating bilateral assistance agreements which provide investigative assistance.

The only portion of the bill with which the Commission disagrees is the requirement that other countries agree to provide "similar assistance" before the Commission can exercise the powers authorized by the bill to assist them. The Commission believes that this requirement could restrict its ability to provide assistance in cases where such assistance

would be in the interest of both foreign and U.S. investors alike.

The legislation also addresses three other international enforcement concerns. First, the legislation would amend Section 24 of the Exchange Act to enable the Commission to maintain the confidentiality of certain foreign evidence. The Commission believes that this amendment would, like Section 101 of the bill, promote agreements on bilateral assistance between the Commission and foreign authorities. There have been instances in which MOU negotiations have been frustrated by the Commission's inability to provide assurances that documents and testimony transmitted to the Commission by the foreign authorities will be kept confidential. The Commission cannot provide assurances of confidentiality because of its disclosure obligations under the Freedom of Information Act ("FOIA"). In order to facilitate the cooperation of foreign authorities in providing the Commission with investigative assistance, the Commission believes that it would be appropriate to exempt documents furnished to the Commission from disclosure if the foreign authorities represent that the disclosure of such documents would violate confidentiality requirements of their country's laws.

Second, the legislation would make explicit the Commission's rulemaking authority to provide documents and other information to foreign authorities under the Canadian and other bilateral assistance agreements, as well as to domestic authorities. Pursuant to Rule 30-4(a)(7), 17 C.F.R. 200.30-4(a)(7), the Commission currently grants access to Commission investigative files to certain securities enforcement entities, including domestic and foreign securities authorities and self-regulatory organizations. However, Section 24(b) of the Exchange Act, as well as provisions of the Investment Advisers Act of 1940 ("Investment Advisers Act") and the Investment Company Act of 1940 ("Investment Company Act"), arguably preclude the disclosure of certain nonpublic documents. In view of the significance of this issue to the Commission's efforts to cooperate both with foreign and domestic securities officials, the Commission believes that it would be appropriate to enact legislation making clear that the Commission, by rule, may provide for the disclosure of nonpublic documents.

Finally, Title II of the bill would amend the Exchange Act, the Investment Advisers Act, and the Investment Company Act to authorize the Commission to censure, revoke the registration of or impose employment restrictions upon securities professionals based upon the findings of a foreign court or foreign securities authority. The Commission already has such authority as to illegal or improper activity in *this* country pursuant to Section 15(b)(4) of the Exchange Act, Section 203(e) of the Investment Advisers Act, and Section 9(a) to expand the field of countries and authorities with which it negotiates mutual assistance agreements. Given the varying degrees of securities regulation and participation in the international securities markets of many foreign countries, there are different levels of interest on the part of other countries in entering into agreements with the Commission. Nonetheless, the Commission is prepared to proceed with negotiations with other countries.

The Commission's approach to international cooperation has been from the perspective that it is in the interest of all countries to have fair and efficient markets that are protected from fraudulent conduct. I believe that the Commission's efforts to develop a network of cooperation with foreign countries are beginning to be successful. The premise that other countries are interested in protecting the integrity of the markets is borne out by the results of a recent Commission initiative at the Organization for Economic Cooperation and Development ("OECD") concerning cooperation in international securities enforcement matters (discussed below at pages 11 - 12), as well as by the reaction of foreign countries to recent major scandals involving international securities trading.

The Commission's bilateral agreements have enhanced its ability to obtain information in a predictable and reliable manner while avoiding cross-border disputes and conflicts. While the Commission has been successful in utilizing unilateral efforts to compel the production of information in U.S. courts, these efforts are costly, time-consuming and unpredictable. Bilateral mutual assistance agreements provide a more predictable and more effective means for obtaining information and documents located outside the U.S. Further, in the long run, as these agreements expand and develop, they will provide a lasting framework for cooperation in the field of international securities regulation. While some jurisdictions may find noncooperation economically advantageous, these havens too will more likely be susceptible to coordinated international efforts.

2. Agreements in Force

The MOUs establish criteria for mutual cooperation. They provide detailed procedures for obtaining information, establish guidelines for handling the Commission's requests so that information can be gathered in a reasonably efficient fashion, and avoid creating friction between the Commission and foreign securities authorities. In addition to facilitating investigations of international securities fraud, the MOUs assist in developing (1) a framework for cooperation, (2) greater experience in addressing international securities law issues, (3) improved communication, and (4) improved working relationships. These agreements are intended to bridge a gap

which often exists between the discovery procedures contained in the more expansive U.S. legal system and the more restrictive foreign systems.

The MOUs apply to specific subject areas without regard to whether the investigations involve offenses under the laws of the signatory countries. The Commission staff carefully scrutinizes all potential cases to ensure that requests fall within the scope of agreements. The Commission therefore does not make requests where it merely has a curiosity about a matter, unless it can articulate the basis for its suspicions. After evaluating a matter as explained above, when the Commission concludes that the matter should be further investigated, it will not hesitate to utilize its MOUs, other agreements, or an informal approach.

The Commission entered into its first MOU in 1982, with Switzerland. Prior to that time, the Commission could utilize the 1977 Treaty on Mutual Assistance between the U.S. and Switzerland to obtain information. 1/ This treaty requires dual criminality, however, and until Switzerland's recent enactment of insider trading legislation, insider trading was not a violation of Swiss law. To ensure the Commission's ability to obtain information in insider trading cases, the governments of the U.S. and Switzerland signed the MOU to establish "mutually acceptable means" for dealing with the problems of insider trading. The Swiss MOU provides a

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1/ The United States is a party to mutual assistance treaties with Switzerland (27 U.S.T. 2019), the Netherlands (T.I.A.S. 10734), Turkey (T.I.A.S. 9891) and Italy (Sen. Ex. 98-25, 98th Cong. 2d Sess.). The mutual assistance treaties between the U.S. and the Netherlands, Turkey and Italy can also be utilized by the Commission to obtain information and evidence in an investigation or during litigation. These treaties provide for the exchange of information in criminal matters and generally require that the violation under investigation constitute an offense under the laws of both the requesting and requested state.

Additionally, the Commission has utilized the Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (the "Convention"), opened for signature March 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444 (discussed below at p.16) to obtain evidence and testimony from the United Kingdom, Guernsey, France and Italy. The Commission recently utilized the Hague Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, open for signature, Nov. 15, 1965, 20 U.S.T. 361-373, T.I.A.S. No. 6638, 658 U.N.T.S., to serve judicial documents in the United Kingdom and Egypt.

mechanism for Swiss banks under certain circumstances to disclose information to the Commission without violating the Swiss bank secrecy laws. The Commission has obtained assistance and information pursuant to the Swiss MOU, and, in one case, successfully pursued a civil injunctive action based on assistance provided pursuant to the MOU. At the time the Swiss MOU was signed, it was agreed that once insider trading was made illegal in Switzerland, the MOU would cease operation. (The recently enacted insider trading legislation in Switzerland will go into effect on July 1, 1988.) To ensure that the Commission will be able to obtain and use information under the 1977 Treaty on Mutual Assistance in insider trading cases when insider trading becomes illegal in Switzerland and the Swiss MOU therefore expires, the U.S. and Switzerland exchanged Diplomatic Notes on November 10, 1987. The Diplomatic Notes specifically provide that in insider trading cases, the 1977 Treaty on Mutual Assistance can be used to provide assistance in Commission investigations relating to serious violations of U.S. securities laws.

MOUs have also been signed with the United Kingdom, Japan and Canada. The Commission entered into the MOU with the Securities Bureau of the Japanese Ministry of Finance in 1986. It provides that each agency will facilitate the other's "respective requests for surveillance and investigatory information on a case-by-case basis." The Japanese MOU designates a specific contact person in each agency to enhance regular communication and processing of requests. Although the Japanese MOU is less specific than the Commission's other MOUs, it has worked when the Commission has sought assistance.

Also in 1986, the SEC, the Commodity Futures Trading Commission, and the United Kingdom Department of Trade and Industry, entered into an MOU which, on a reciprocal basis, provides assistance in obtaining records that are in the hands of the other agency or that can be obtained through the best efforts of the parties to the MOU. The U.K. MOU is viewed as an interim arrangement intended to be a first step in the parties' efforts to establish a comprehensive understanding to provide bilateral cooperation relating to securities regulation. The U.K. MOU makes assistance available in matters involving insider trading, market manipulation and misrepresentations relating to market transactions. It also provides for exchange of information in matters relating to the oversight of the operational and financial qualifications of investment businesses and brokerage firms. The Commission has on numerous occasions received and provided assistance and information pursuant to the U.K. MOU.

Finally, the Commission entered into an MOU on January 7, 1988, with the Ontario, Quebec and British Columbia securities commissions. It is the most comprehensive of the Commission's MOUs entered into to date, exceeding the scope of assistance available under, and subject matter covered by, its other MOUs. It provides that the parties will provide each other with the fullest mutual assistance possible where information needed by one authority is in the territory of the other. The MOU provides that assistance will be available in the full range of cases investigated by the Commission. The Canadian MOU has already proven to be an effective means of obtaining and providing mutual assistance, and can be used as a basis for future agreements with other foreign regulatory authorities. It also provides that the parties will use their subpoena authority, where necessary, to obtain the information requested by another authority. The Quebec Securities Commission is the only signatory with such investigative authority at the present time. 2/ The signatories to the MOU agreed to take "all reasonable steps" to obtain such statutory authority to permit investigations of securities law violations at the request of a foreign authority. To fulfill that commitment under the Canadian MOU and to enhance the Commission's enforcement capabilities, the Commission recently recommended enactment of legislation similar to the recently introduced International Securities Enforcement Cooperation Act of 1988.

The MOUs generally have provided an effective and efficient means of obtaining information and have enhanced the Commission's enforcement capabilities. Although the Commission's MOUs are not in all cases comprehensive, the Commission is actively working to improve existing agreements and to develop new ones. The Commission is at various stages of negotiations of MOUs with several countries, and anticipates that additional agreements will be entered into in the near future.

B. Informal Arrangements and Contacts With Foreign Authorities

The Commission has developed several means for obtaining information where it has no formal agreements. It has been able to obtain information on a case-by-case basis; as a result of its participation in multilateral organizations; and through imposition of requirements in approving certain intermarket exchange linkages.

2/ Securities Act, Qub. Rev. Stat. ch. V-1 (1977). To our knowledge, the only other country with such authority is Switzerland, which provides such investigative assistance in cases where the offense under investigation would also violate Swiss criminal law and where reciprocal assistance is available from the requesting country.

securities regulators. These meetings have been attended by representatives from the securities authorities of Australia, Canada, the Federal Republic of Germany, France, Great Britain, Hong Kong, Japan, the Netherlands, Switzerland and the U.S. The meetings have focused on four areas: a) the negotiation of Memoranda of Understanding; b) the current ability of securities authorities to compel the production of records for or otherwise provide assistance to a foreign securities authority; c) confidentiality and other restrictions on the use of information provided to a foreign securities authority; and d) current exchanges of information. While no specific agreements have been reached, the constructive exchange of views which has occurred facilitates future bilateral agreements and relationships with foreign regulators.

The Commission has an ongoing dialogue with the major participants in the international securities markets, most of whom are members of the Organization for Economic Development and Cooperation ("OECD"). The OECD Committee on International Investment and Multinational Enterprises, Working Group on International Investment Policies has, at the Commission's initiative, agreed to undertake a work program regarding extraterritorial information requirements in the field of securities. The Commission's staff, working with the OECD Secretariat, developed a questionnaire on this topic which was circulated to all member countries. Nineteen countries have responded to the questionnaire, and a draft report summarizing the responses was circulated in February 1988.

Participation in the OECD has provided a useful multilateral forum for discussing information requirements and international evidence gathering relating to securities. Further, the questionnaire has provided an excellent vehicle for exploring the similarities between U.S. and foreign extraterritorial information requirements. Responses to the questionnaire demonstrate a mutuality of interest in the enforcement area. Specifically, the responses indicate:

> (1) All responding countries have specific securities legislation or laws of general applicability relating to the prevention of securities-related fraudulent, deceptive or manipulative acts and practices. While these regulations differ in scope and specificity, members responding to the questionnaire share an interest in preventing fraud on securities exchanges.
>
> (2) All responding countries recognize that cross-border trading and/or offerings of securities requires the nationals of one country to register in and/or be subject to the laws of, other countries. Accordingly, when those laws are violated, information may be sought from beyond the borders of the enforcing countries.

> (3) All responding countries expressed a willingness to provide assistance to other member countries, consistent with domestic law.

The Commission intends to utilize these areas of mutual interest to develop and enhance information-sharing agreements on a bilateral basis.

In another area, the Commission has conditioned its approval of trading linkages between domestic and foreign stock exchanges upon a commitment by the foreign exchanges to provide surveillance information upon request. For example, on August 21, 1987, the Commission approved a licensing agreement permitting the European Options Exchange ("EOE"), located in Amsterdam, to trade options on the Major Market Index ("XMI") that are fungible with XMI contracts traded on the American Stock Exchange. The unique feature of this approach was that it contained a mechanism to ensure that customers of foreign institutions could be identified in all cases, consistent with Netherlands privacy laws. To effect this, the EOE adopted a rule requiring a waiver of Netherlands secrecy laws to allow customer identification for surveillance purposes. This approach avoids the possibility of any confrontation or difficulty in pursuing a case involving XMI trading.

While our work is far from finished, I believe the Commission's initiatives have provided the basis for effective and efficient assistance in the investigation of violations of U.S. law.

C. Unilateral Action

In cases where it has no MOU or informal arrangement, the Commission will consider other alternatives. If the information is within a country from which we have had no success in obtaining information, we will consider whether we can effectively investigate without the information. For example, in SEC v. Zico Investment Holdings, Inc., 87 Civ. 8487 (S.D.N.Y.), a case in which bank information was located in Luxembourg, a country with which the Commission has no agreement relating to the exchange of information, the Commission was able to develop sufficient evidence to support allegations of manipulation by the defendants without seeking the underlying bank records from that country. This case recently settled, with several of the defendants consenting to, among other things, the entry of permanent injunctions from future violations of the federal securities laws.

If cooperation or assistance is not available, the Commission staff also will consider whether the case is strong enough on the merits to request an immediate court-ordered freeze of assets to prevent the wrongdoer from recovering ill-gotten gains, and thereafter will seek an order compelling the identification of the purchaser. For example, in *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981), a case which antedated the Swiss MOU, the Commission, after discovering substantial Swiss bank trading just before the 1981 takeover bid for St. Joe Minerals Corporation by Joseph E. Seagram and Company, obtained a court ordered freeze and later moved for an order to compel a Swiss bank to disclose its customers' identities. The court granted the Commission's motion. Thereafter, the Swiss bank obtained a waiver of Swiss secrecy laws from its customers and provided the Commission with their identities. This information was critical to the Commission's civil injunctive action against multiple defendants in the underlying case, in which the Commission obtained injunctions and orders of disgorgement.

In cases where neither the alleged illicit profits nor the evidence relating to the matter under investigation are within the U.S., absent an international agreement, the Commission has no good options for obtaining information in another sovereign's territory. Accordingly, in such cases, the Commission is unable to pursue the matter. This problem is not dissimilar to that encountered by the Department of Justice when it seeks to prosecute individuals, such as drug smugglers, who choose to remain fugitives after committing a U.S. crime. Thus, without cooperation from the foreign state involved, even our most diligent efforts may fail.

D. *International Securities Enforcement Act of 1988*

1. *Limitations of Current Laws and the Benefits of Bilateral Agreements*

The U.S. securities laws provide generally that the Commission's investigative subpoena power extends only to the production of documentary and testimonial evidence "from any place in the United States or any State." 3/ If an individual or entity located in a foreign country refuses to cooperate

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3/ Section 21(b) of the Exchange Act, 15 U.S.C. 78a(c). *See*, *CFTC v. Nahas*, 783 F.2d 487, 493 (D.C. Cir. 1984) (construing a provision in the Commodity Exchange Act which at the time was nearly identical to Section 21(b) and (c) of the Exchange Act); *cf*. *SEC v. A.H. Zanganeh*, 470 F. Supp. 1307 (D.D.C. 1978) (holding that the SEC could not subpoena the testimony of a foreign witness merely by serving the subpoena at the offices of a U.S. corporation organized to hold funds for his children).

voluntarily in the investigation, the Commission must seek the assistance of a foreign sovereign, or wait until the individual enters the United States, to develop the necessary evidence. Even where the Commission effectively serves a subpoena in the United States to compel a person located here, or a subsidiary of a foreign corporation located here, to provide documents located abroad, 4/ subpoena enforcement actions and contempt proceedings in such cases are expensive and protracted. In addition, particularly when secrecy laws are at issue 5/, court enforcement of a subpoena engenders the hostility of the foreign country, which views such a proceeding as an infringement of its sovereignty. 6/

Once a lawsuit has commenced, the Commission has additional means of obtaining discovery. As to parties, a court may compel discovery, including testimony and the production of documents, pursuant to Federal Rules of Civil Procedure ("Fed. R. Civ. P.") 37. However, as with investigative subpoenas, the issuance of litigation subpoenas may create friction with foreign authorities. As to foreign nonparties, a court may issue letters rogatory to a foreign court pursuant to Fed. R. Civ. P. 28(b)(3). Where the country in which evidence is sought is a signatory to the Hague Evidence Convention, the Commission may use letters of request, which are similar to letters rogatory.7/ Those procedures, however, can be extremely slow and expensive. In addition, restrictions on discovery techniques in certain countries --

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4/ *See, e.g.*, *SEC v. Minas de Artemisia, S.A.*, 150 F.2d 215 (9th Cir. 1945); *see also*, *In re Marc Rich & Co.*, 707 F.2d 663 (2d Cir.), *cert. denied*, 463 U.S. 1215 (1983) (criminal tax investigation).

5/ Secrecy laws forbid the disclosure of business records or the identity of bank customers. The right to secrecy is held by the person whose secrecy is to be protected and can be waived solely by that person. *See generally*, Pitt, Hardison, and Shapiro, *Problems of Enforcement in the Multinational Securities Market*, 9 U. Pa. J. of Int'l Bus. Law 395, 402-09 (1987).

6/ Another means of gathering evidence located abroad is the use of criminal assistance treaties, discussed at pp. 7-8, *supra*.

7/ *See generally*, E. Greene, A. Cohen, and L. Matlack, *Problems of Enforcement in the Multinational Securities Market*, 9 U. Pa. J. of Int'l Bus. Law 325, 344-45 (1987).

such as limitations on the right of counsel to directly examine witnesses -- can render such procedures inadequate.8/

As a result of these difficulties, the Commission's enforcement efforts are greatly enhanced by bilateral agreements between the Commission and foreign countries and securities authorities. Such agreements, which bring the Commission and its equivalent foreign regulator into a cooperative relationship, provide powerful means for international securities enforcement. 9/ As discussed above, the Commission currently has bilateral MOUs with Switzerland, the Japanese Ministry of Finance, the United Kingdom Department of Trade and Industry and the Ontario, Quebec, and British Columbia securities commissions, and is currently seeking similar agreements with several other foreign authorities.

The Commission's existing statutory authority, however, does not permit full cooperation between the Commission and foreign authorities in international investigations. The British MOU exemplifies the limitations. Under that agreement,

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8/ *See*, *Societe Nationale Industrielle Aerospatiale v. U.S. District Court for the Southern Dist. of Iowa*, 107 S.Ct. 2542 (1987) ("In many situations the Letters of Request procedure authorized by the [Hague Evidence] Convention would be unduly time consuming and expensive as well as less certain to produce needed evidence than direct use of the Federal Rules").

9/ One commentary has described the benefits of MOUs as follows:

> The advantages of MOUs from the SEC's viewpoint are significant. First, a MOU can establish detailed procedures governing areas of concern. Second, a MOU can establish a timetable governing the handling of the SEC's request, and place reasonable limitations on customers' rights to appeal decisions to grant the SEC access. In addition, a MOU need not be formally ratified by the United States Senate and the corresponding body in the foreign jurisdiction, which permits the SEC to invoke the MOU's provisions at an earlier date. From the perspective of foreign jurisdiction, MOUs offer hope that the SEC will refrain from invoking the compulsory processes of the United States court which are viewed as a challenge to the sovereignty of the foreign jurisdiction.

Pitt, Hardison and Shapiro, *Problems of Enforcement in the Multinational Securities Market*, 9 U. Pa. J. of Int'l Law 375, 435 (1987).

each country undertakes to provide the other with "any information" that it has "in its hands" or that it can by "best efforts" obtain. In some cases, the Commission has important information in its hands. In other cases, where there is evidence of a law violation in both this country and the foreign country, the Commission may investigate and then exchange information with the foreign country. But where there is no independent basis for investigating a violation of U.S. law, the Commission lacks authority to compel testimony or production of documents on behalf of a foreign securities authority. 10/ For example, if a U.S. bank holds documents evidencing the proceeds of a securities law violation which took place entirely abroad, and as to which the Commission therefore lacks jurisdiction, the Commission has no authority to compel production of the documents. The Commission's "best efforts," in other words, may in some cases be ineffective.

Foreign authorities confront many of the same obstacles to evidence gathering in this country that the Commission encounters in foreign countries. Absent voluntary cooperation of witnesses, U.S. law does not make it feasible for foreign securities authorities to obtain evidence in this country on their own. Absent assistance by the Commission or other government agencies, the only procedure now available to a foreign government seeking to investigate securities fraud in this country is letters rogatory under 28 U.S.C. 1782. That statute allows a federal district court, at the request of a "foreign or international tribunal," to issue letters rogatory to persons within its district to give testimony or produce evidence. The term "tribunal," however, has been interpreted as meaning a judicial or quasi-judicial body. 11/ As a result, the letters rogatory procedure may not be available to foreign regulatory authorities in the investigative stage. In any event, the letters rogatory application must be reviewed by the U.S. court in an open proceeding. The public nature of the process and the frequent delays in U.S. courts make this procedure an impractical means for foreign authorities to investigate many securities law violations.

10/ For example, under Section 21(a) of the Exchange Act, the Commission's investigatory authority is generally limited to inquiries involving the laws it administers.

11/ *See, e.g.*, *Fonseca v. Blumenthal*, 620 F.2d 322 (2d Cir. 1980). *But see*, *Letter of Request from the Crown Prosecution Service of the United Kingdom*, No. 88-0028 (D.D.C., March 21, 1988); *In re Request for Assistance from Ministry of Legal Affairs of Trinidad and Tobago*, 648 F. Supp. 464 (S.D. Fla. 1986).

2. Legislation Authorizing Evidence Gathering on Behalf of Foreign Authorities

The Commission negotiated the Canadian MOU, described above, to address these problems. The proposed legislation will fulfill the Commission's commitment under the Canadian MOU to obtain statutory authority that would permit investigations of securities law violations at the request of a foreign authority. In addition, the Commission is negotiating MOUs with other countries which are similar to the Canadian MOU. These cooperative approaches to evidence-gathering will be less expensive and time consuming than the alternatives described above, such as letters rogatory. 12/ In addition, at least in the short-term, such arrangements are likely to benefit the Commission more than foreign countries, which in many cases do not have the statutory authority to pursue as broad a range of securities law violations as does the Commission. 13/

The Commission supports the enactment of the recently introduced International Securities Enforcement and Cooperation Act of 1988. We believe that this legislation will provide the Commission with a substantial tool to develop international cooperation and to improve its ability to obtain evidence from abroad. This legislation would expand the Commission's authority under Section 21 of the Exchange Act to allow a Commission investigation for the purpose of assisting a foreign authority in determining whether a violation of the laws it administers has occurred, is occurring, or is about to occur. The Commission's discretion to open the investigation to assist a foreign authority would be governed by the same standards as a domestic violation. As a result, the proposal brings into play the full range of investigative procedures and remedies at the Commission's disposal, including the issuance and enforcement of subpoenas. By utilizing the investigative framework which already is in place, the proposal provides a vehicle with which the Commission and the legal community are familiar for assisting foreign authorities.

The legislation would give the Commission the discretion to issue a formal order of private investigation to assist in gathering information regarding alleged violations of foreign laws relating to securities matters. A foreign authority seeking the Commission's assistance would submit a request detailing the facts which constitute a potential violation of its laws. 14/ The Commission would review this request and make a determination whether to issue a formal order. If a formal order were issued, the staff members appointed as officers of the Commission for purposes of the investigation would conduct an investigation in the U.S., gathering the requested information as they would pursuant to any formal order. Thus, the Commission staff would reserve control of the investigation in the U.S.

Because the proposed legislation relies upon established formal order procedures, it provides witnesses with all of the protection and remedies afforded to witnesses in Commission proceedings. Accordingly, witnesses could obtain access to a formal order identifying the basis and subject matter of an investigation. Further, they would be able to resist enforcement of a burdensome subpoena. In this regard, any challenge to a Commission subpoena would have to be reviewed by the Commission as part of the authorization process for a subpoena enforcement action. It is likely that persons resisting subpoenas would make their reasons known at the time they initially resist the subpoena. This information would be available to the Commission for its consideration before a decision was made to institute a subpoena enforcement action. Accordingly, the Commission would have an opportunity to review the matter, and the facts as argued by the subject of the subpoena, before seeking a court determination. The Commission believes that, by providing a witness with the same rights and protections provided to witnesses in Commission investigations, the proposed legislation resolves any constitu-

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12/ The Commission works closely with the Departments of State and Justice in its international enforcement efforts and, as a result, does not anticipate that the proposed legislation will create any conflicts with the Executive Branch. Moreover, any such conflicts would more likely occur when the Commission pursues an investigation abroad, as it currently does, than when the Commission agrees to investigate a matter in the United States at the request of a foreign authority, as the proposed legislation would permit.

13/ *Cf*. Greene, *supra* note 7, at 355 ("although agreements for assistance may be a more tangible benefit to the SEC in the short run, both the United States and foreign nations are likely to desire such assistance in the long run").

14/ For example, under the MOU with the U.K. Department of Trade and Industry, a request is required to clearly set forth: (a) the information requested; (b) the general purpose for which the information is sought, indicating in particular the legal rule or requirement pertaining to the matter which is the subject of the request; (c) the grounds on which breach of the legal rule or requirement is suspected or the reason the information is otherwise sought; (d) the identity of the person whose conduct causes concern.

tional due process and Fourth Amendment concerns which could be raised. 15/

The legislation restricts assistance requests to "foreign securities authorities." That term is defined in the amendments as "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters." This definition recognizes that countries have different approaches to securities law enforcement. In some countries -- the United Kingdom, for example -- jurisdiction over securities law enforcement has been assigned by statute to a government authority. In still other countries, a private agency is authorized to act as the primary administrator or enforcer for securities matters. The definition of "foreign securities authority" would encompass:

a) foreign independent regulatory agencies similar to the Commission, such as the Commission des Operations de Bourse in France and the Canadian provincial securities commissions, as well as foreign Executive agencies, such as the British Secretary of State for the Department of Trade and Industry, which hold express statutory authority to enforce securities laws;

(b) general policing entities, such as the Swiss Federal Department of Justice and Police, which enforce commercial, corporation and financial laws or other generalized fraud statutes; and

(c) self-regulatory organizations ("SRO"), such as the U.K. Securities and Investment Board (as of April 1988), to the extent the SRO is not merely a membership organization but also "administers" or "enforces" securities laws.16/

The proposed amendment provides the Commission with discretion to grant or deny assistance. As a result, the Commission would not be in the position of providing assistance to an agency or regulatory organization of uncertain legal authority, or in response to an unreasonable or ill-founded request.

The recently introduced legislation requires that before the Commission may provide assistance, the requesting authority must agree to provide the Commission with similar investigative assistance. No doubt, this amendment would thus provide a substantial incentive for foreign securities authorities to enter into mutual assistance arrangements with the Commission or to make commitments to provide information in similar situations. However, the Commission is concerned that it could also tie the Commission's hands in cases where assistance may be justified and appropriate but where a foreign authority is not in a position to make a commitment to provide similar assistance. The Commission anticipates that it will rarely grant assistance to foreign authorities that would be unwilling to reciprocate by responding favorably to a Commission request. However, there may be cases in which the Commission might conclude that granting assistance to a foreign authority will promote the development of a mutual assistance relationship. A "reciprocity" requirement would unnecessarily restrict the Commission in its relationships with foreign securities authorities and would limit the Commission's ability to provide assistance even when doing so would advance the Commission's goal of protecting U.S. markets. For this reason, we would propose deleting this requirement for similar assistance and adding it as a factor which the Commission must consider in determining whether, in its discretion, assistance should be made available.

15/ Because testimony would be taken pursuant to existing investigative procedures, a witness would be entitled to assert all relevant rights and privileges of the United States. In addition, a witness would be entitled to assert privileges available in the country seeking the evidence even in cases where the United States does not recognize the privileges. Issues of privilege would be preserved on the record for later consideration by a court of the requesting authority. The Commission believes that foreign countries providing reciprocal assistance to the Commission will follow a similar procedure.

16/ SROs which do not "enforce" or "administer" securities laws are included under this legislation in the broader definition of "foreign financial regulatory authority." By requiring that the "foreign securities authority" be the originator of requests, the Commission likely will receive requests for assistance from a single authority or only a few authorities in one country instead of from a wide range of SROs with varying responsibilities. This approach will enable the Commission to develop a working relationship with the authorities who have the broadest legal mandate to oversee securities matters in their country.

3. Legislation authorizing the Commission to withhold from disclosure documents furnished to the Commission by foreign securities officials.

The legislation also would amend the securities laws to permit the Commission to assure confidential treatment for records produced under reciprocal arrangements with foreign securities authorities. The Commission cannot provide assurances of confidentiality because of its disclosure obligations under the Freedom of Information Act ("FOIA"). The legislation would exempt from the FOIA documents furnished to the Commission if the foreign authorities represent that the disclosure of such documents would violate confidentiality requirements of their country's laws.

In entering into MOUs with the Commission, authorities in foreign countries have committed themselves to obtaining and providing the Commission with certain documents, some of which otherwise would be kept confidential. While these authorities have determined that it is appropriate to permit public use of documents, which otherwise must be kept confidential, when the Commission prosecutes securities law violators, they have expressed concern about the disclosure of such documents when the Commission decides not to prosecute a particular matter.

The Commission's disclosure obligations under the FOIA are the same for records obtained from foreign securities authorities as they are for records obtained from other sources, *i.e.*, the documents must be disclosed under the FOIA unless they fall within a specified FOIA exemption. Because of these FOIA obligations, foreign securities authorities have expressed concerns about providing the Commission with information relevant to ongoing investigations. They have also stated that their own domestic laws preclude them from entering into agreements with the Commission unless the Commission is able to fulfill the confidentiality requirements of the foreign country's laws. In some cases, MOU negotiations have been frustrated by the Commission's inability to provide assurances that documents and testimony transmitted to the Commission by foreign authorities will be kept confidential.

Enactment of Section 102(d) of the attached bill would establish an exemption from disclosure under the FOIA. The amendment would not undermine the policies underlying the FOIA. Indeed, the Commission believes that principles of comity make it appropriate to exempt from disclosure confidential documents obtained from a foreign government if those documents could not be disclosed under the laws of that foreign government. Moreover, adoption of such an amendment will almost certainly allow the Commission to obtain otherwise unobtainable confidential documents from foreign countries for law enforcement purposes. These considerations warrant enactment of the FOIA exemption.

The proposed Section 24(d) would supersede the FOIA by authorizing the Commission to withhold from disclosure documents obtained from a foreign securities authority if the foreign authority has in "good faith" represented to the Commission that public disclosure of such records would be contrary to the laws of the foreign country. The term "foreign securities authority" would include, as discussed above (*supra*, p. 20), government agencies and self-regulatory organizations which "administer" or "enforce" the securities laws. The amendment would not restrict the Commission's use of the information and documents obtained from a foreign authority in its investigations or for enforcement purposes. Nor would it limit the ability of the Congress to obtain information in the Commission's possession or preclude defendants in actions commenced by the United States or the Commission from seeking, through discovery or otherwise, such documents. 17/

The amendment would add a new Section 24(e) to make clear that the amendment would not prevent the Commission from complying with a request for information from the Congress or from complying with an order of a court of the United States in an action commenced by the United States or the Commission. This amendment would replace the current last sentence of Section 24(b) of the Exchange Act, which provides that "nothing in this subsection shall authorize the Commission to withhold information from the Congress."

By providing authority for the Commission to withhold from disclosure certain records obtained from foreign securities authorities "in response to a request pursuant to the Freedom of Information Act," the amendment clearly would supersede the disclosure obligations imposed by the FOIA, and hence would not require that the Commission rely on a FOIA exemption in order to withhold from disclosure confidential documents.18/ In addition, the determination whether foreign law prohibits the disclosure would be made by the foreign authorities, not by the

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17/ The amendment, by providing "notwithstanding the provision of * * * any other law," would also provide authority for the Commission to withhold documents subject to a third-party subpoena.

18/ Certain statutes have been found to preempt or supersede the FOIA. *See, e.g.*, *Ricchio v. Kline*, 773 F.2d 1389, 1392 (D.C. Cir. 1985)(holding that the FOIA was preempted by the Presidential Recordings and Materials Preservation Act, the sole purpose of which is "to preserve" and "to provide access to" a certain specific body of records).

Commission. That decision must, however, be made in good faith. 19/

4. Legislation granting the Commission rulemaking authority to permit access to its files by persons, both domestic and foreign, engaged in securities law enforcement and oversight.

The Commission's Rules of Practice 20/ authorize the Director of the Division of Enforcement to provide access to non-public materials in the Commission's investigative files to domestic and foreign governmental authorities, self-regulatory organizations, and other specified persons. In addition, Rule 2 of the Commission's Rules Relating to Investigations authorizes designated members of the Commission staff to "engage in discussions" concerning the nonpublic materials with the persons specified in Rule 30-4(a)(7). 21/ These access

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19/ Absent a "good faith" standard, the statute might bind the Commission to follow the dictates of a foreign government. The "good faith" requirement would permit the Commission to inquire into the legitimacy of the foreign government's non-disclosure request and would provide some basis for judicial review of the Commission's decision.

20/ Rule 30-4(a)(7), 17 C.F.R. 200.30-4(a)(7).

21/ 17 C.F.R. 203.2. Other relevant rules include: Rule 2.5(b) of the Commission's Rules On Informal and Other Procedures, 17 C.F.R. 202.5(b), which states that the Commission may "grant requests for access to its files made by domestic and foreign governmental authorities, self-regulatory organizations such as stock exchanges or the [NASD], and other persons or entities"; Administrative Regulation 19-1(1)(b), SECR 19-1(1)(b), which provides that "the prohibition[s] against the use of non-public information or documents" imposed by various Commission rules do "not apply to the use of such materials as necessary or appropriate by members of the staff in pursuing Commission investigations, examinations or in the discharge of other official responsibilities"; Administrative Regulation 19-1(1)(c), SECR 19-1(1)(c), which sets forth a policy approving the use of non-public materials and the furnishing of "such assistance as may be required for the effective presentation or prosecution of a case" in circumstances where the Commission refers matters to the Justice Department or grants access to its files to any federal, state or foreign government authority; and the Commission's uncodified policies and procedures concerning the "routine uses" of systems of records in the Commission's possession that are covered by the Privacy Act. See 41 Fed. Reg. 41550 (September 22, 1976) and (continued...)

rules have frequently provided the essential basis for prosecutions of securities law violations by other enforcement agencies and SROs.

The Commission's access rules are long-standing. However, Section 24(b) of the Exchange Act, 15 U.S.C. 78x(b), enacted in 1975, makes it unlawful "for any member, officer, or employee of the Commission to disclose to any person other than a member, officer or employee of the Commission, or to use for personal benefit, any information contained in any application, statement, report, contract, correspondence, notice or other document filed with or otherwise obtained by the Commission (1) in contravention of the rules and regulations of the Commission under [the FOIA], or (2) in circumstances where the Commission has determined pursuant to such rules to accord confidential treatment of information." Section 24(b) was intended to make all requests for confidential treatment of information subject to the FOIA rules. 22/ There is nothing in the FOIA legislative history suggesting that Congress intended to undermine the Commission's access program. Nevertheless, the literal language of Section 24(b) seems to do precisely that: documents that are determined under the FOIA to be confidential cannot be disclosed.

In most situations, the Commission receives an access request before the staff makes a confidential treatment determination, and Section 24(b) would not, therefore, be at issue. On occasion, however, Section 24(b) can pose an obstacle to compliance with an access request.

Additional problems with the Commission's access program may arise from other statutory provisions. Section 210(b) of the Investment Advisers Act bars the staff from making public information relating to a Commission investigation if it was obtained pursuant to that Act, unless the Commission expressly authorizes such disclosure (with an exception for public hearings and disclosure to Congress). Section 45(a) of the Investment Company Act imposes a bar on the disclosure of non-

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21/(...continued)
"SEC Systems of Records--Privacy Act of 1974" (July 1983) (unofficial document).

22/ Prior to the 1975 Amendment, the Commission provided confidential treatment under both the FOIA rules and under Section 24(a), which at that time prescribed standards for granting confidential treatment to information filed with the Commission. The Amendments were intended to end the latter procedure. See S. Rep. No. 94-75, 94th Cong., 1st Sess. 137, reprinted in 1974 U.S. Cong. & Admin. News 179, 314.

public documents obtained by the Commission pursuant to that Act, except insofar as disclosure is made to federal or state government officials.

To remove these apparent obstacles to the Commission's authority to grant access to its files to domestic and foreign authorities, we agree that the Exchange Act should be amended to provide the Commission with explicit authority in this area.

The proposed amendment would grant the Commission rulemaking authority, rather than list the specific persons to whom access may be given. As a result, the Commission will have flexibility in adjusting its access rules in the future. In addition, by specifying that the Commission may permit access by foreign persons, the Commission's authority as to this matter will be made explicit. 23/ The provision as to confidentiality of records would ensure that the Commission will not provide records to persons who will make the records public for purposes other than those stated in an access request. 24/

The legislation would not alter the certification and notice requirements imposed by the Right to Financial Privacy Act ("RFPA"), 12 U.S.C. 3401 et seq. Under Section 1112(a) of the RFPA, the Commission may not transfer to other federal agencies financial records that were obtained by the Commission subject to the RFPA procedures unless it certifies in writing that there is reason to believe that the records are relevant to a legitimate law enforcement inquiry within the jurisdiction of the receiving agency or department. In addition, the Commission must send the customer a copy of such certification and a notice which both describes the nature of the law enforcement inquiry and informs the customer of potential legal rights under relevant privacy statutes. These requirements do not apply to transfers of information to non-federal agencies, foreign authorities, or self-regulatory organizations.25/

5. Legislation authorizing the Commission to impose sanctions on securities professionals for violations of foreign laws.

a. Overview

One likely result of efforts by foreign securities authorities to strengthen their securities law enforcement will be an increase in the number of enforcement or disciplinary proceedings brought against securities professionals, such as brokers, dealers, and investment advisers. Indeed, if Section 101 of the proposed legislation is enacted, such actions may result at least in part from the assistance provided to foreign authorities by the Commission pursuant to that section. The Commission, however, currently does not have explicit authority to impose administrative sanctions against such professionals based upon foreign findings of their illegal or improper foreign activities (although, as discussed below, the Commission has some authority in this area). The proposed legislation provides that the Commission may impose sanctions on securities professionals who have been found to have engaged in misconduct abroad when, had the same misconduct taken place in the United States, the professional would have been subject to a Commission disciplinary proceeding. This amendment would give the Commission discretion to bring an administrative proceeding based on foreign misconduct, just as it has discretion to bring such actions based on domestic misconduct. Title II of the bill therefore would amend Sections 15(b)(4) and 3(a)(39) of the Exchange Act; Section 9(b) of the Investment Company Act; and Section 203(e) of the Investment Advisers Act to provide the Commission with this express authority and to add to the Commission's existing authority.

b. Specific concerns

U.S. broker-dealers, investment advisers, and investment companies have increased significantly their activities in foreign markets. 26/ The activities of foreign professionals

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23/ By including the phrase "notwithstanding any other provision of law," the amendment will supersede the disclosure provisions of Section 45(a) of the Investment Company Act and Section 210(b) of the Investment Advisers Act.

24/ Commission policy now requires that the person making the access request state the purposes for which the requested information will be used and certify that no public use will be made of the information except for the purposes specified. These or similar procedures would continue to be used after the legislation is enacted. In addition, in the international context, MOUs delineate the public uses that can be made of information which the Commission provides pursuant to the access program.

25/ See H.R. Rep. No. 95-1383, 95th Cong., 2d. Sess., (1978) at 247.

26/ See Internationalization of the Securities Markets, Report of the Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce, dated July 27, 1987, Chapter II. As (continued...)

in the U.S. markets also are likely to increase. 27/ As a result, the Commission is likely to confront a growing number of securities professionals who have been disciplined abroad for illegal or improper activities working or seeking to work in this country.

26/(...continued)
to investment companies, the report states that there has been a dramatic increase in the number of U.S. investment companies that emphasize foreign securities in their portfolios and that it has become more common for investment companies registered in the U.S. to issue their securities in foreign markets. As of January 1988, there were 154 registered investment companies of all types that concentrate their portfolio securities in foreign securities. These funds, which are widely held by U.S. investors, use foreign broker-dealers to execute portfolio transactions, foreign custodians to hold portfolio securities and foreign advisers to help manage their portfolios. As to broker-dealers, major foreign markets usually facilitate entry by granting national treatment to U.S. securities firms. France has substantially increased access to its markets by foreign firms, id. at V-3, and the Tokyo Stock Exchange recently increased the number of seats allocated to foreign firms. Affiliates of U.S. broker-dealers now engage in significant market-making activities in London. Id. at V-21.

27/ See id. at I-14-16; II-78-90. The report indicates that over 120 investment advisers from 20 countries have registered with the Commission. As to investment companies, in 1984, the Commission transmitted a legislative proposal to Congress that would amend Section 7(d) of the Investment Company Act to give the Commission greater flexibility in permitting foreign investment companies access to the U.S. securities markets. Although this proposal never was introduced in either House of Congress, the Commission anticipates renewed interest in a legislative proposal to amend Section 7(d). In addition, the Commission is considering the possibility of reciprocal arrangements between the U.S. and foreign nations with respect to multinational offerings of mutual fund securities. Finally, recently-adopted Rule 6c-9 will facilitate the offering of foreign bank securities in the U.S. Investment Company Act Rel. No. 16093 (Oct. 29, 1987).

As to broker-dealers, about 150 foreign firms had established branches in the United States as of 1987; for their part, U.S. firms had over 250 branches in foreign countries, excluding Canada and Mexico. Id. at Chapter V, Appendix B-66 (remarks of James M. Davin, Vice-Chairman, NASD).

The Commission currently has substantial authority to curtail the securities activities of certain convicted criminals and other wrongdoers for illegal or improper conduct in this country. Under Section 15(b)(4) and (b)(6) of the Exchange Act, the Commission may censure, limit the activities, functions, or operations of, suspend for up to twelve months, or revoke the registration of any broker or dealer, or bar from association with any broker or dealer, any person: found to have violated the federal securities laws, rules, or regulations thereunder; convicted of a "felony or misdemeanor" within the preceding ten years involving specified crimes; who willfully has filed a false or misleading statement in any registration statement or report filed with the Commission; or who has willfully aided and abetted a violation of any portion of the federal securities or commodities laws. Such a person also is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act. 28/ Section 203(e) and (f) of the Investment Advisers Act provides the Commission with disciplinary authority as to investment advisers and persons associated with registered investment advisers, similar to that in Section 15(b)(4) and (6) of the Exchange Act. 29/

In addition, Section 9(a) of the Investment Company Act generally prohibits a person convicted of a securities-related crime or subject to a securities-related injunction from serving as an employee, officer, director, member of an advisory board, investment adviser, or depositor of a registered investment company, or principal underwriter for any registered open-end company, unit investment trust, or face-amount certificate company. The automatic statutory disqualification in Section 9(a) is supplemented by the

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28/ As a result, when such a person seeks to become associated with a member of an SRO, that SRO and the Commission have the opportunity to give special review to the person's employment application or to restrict or prevent reentry into the business where appropriate for the protection of investors. See Section 15A(g)(2) of the Exchange Act and Rule 19h-1 thereunder.

29/ Section 15(b)(6) of the Exchange Act and Section 203(f) of the Investment Advisers Act authorize the Commission to limit the activities of a person associated or seeking to become associated with a broker-dealer or investment adviser if the Commission finds that the person has committed any of the acts or has been convicted or enjoined as designated in Section 15(b)(4) or Section 203(e). As a result, any addition to the Commission's authority under Section 15(b)(4) and Section 203(e) will, by implication, expand the Commission's authority under Section 15(b)(6) and Section 203(f).

Commission's authority under Section 9(b). Under Section 9(b), the Commission may prohibit a person from serving in any of the capacities cited in Section 9(a) or as an affiliated person of a registered investment company's investment adviser, depositor, or principal underwriter if the person willfully has caused a false or misleading statement to be made in any registration statement or report filed with the Commission or if the person has willfully violated or aided and abetted a violation of any provision of the federal securities or commodities laws.

Although the foregoing provisions do not mention the Commission's authority to impose sanctions based on *foreign* misconduct, certain of the provisions can be so applied. In particular, Sections 15(b)(4)(B) of the Exchange Act, 203(e)(2) of the Investment Advisers Act, and 9(a)(1) of the Investment Company Act refer to a "felony or misdemeanor" conviction for specified crimes; neither the statutes nor their legislative histories specify that the crime or conviction must take place in the United States.30/ Thus, pursuant to Section 15(b)(4)(B), the Commission revoked the U.S. registration of a Canadian broker-dealer who was convicted of crimes in Canada involving the purchase or sale of securities.31/ Likewise, under Sections 15(b)(4)(C) of the Exchange Act and 203(e)(3) of the Investment Advisers Act, the Commission may impose sanctions based upon a securities-related injunction entered by a "court of competent jurisdiction," and under Section 9(a)(2) of the Investment Company Act, such an enjoined person's association with a registered investment company is limited. These statutes are not explicitly limited to injunctions entered by U.S. courts. *See* L. Loss, *supra* at 1305 (stating that a "court of competent jurisdiction" as set forth in Section 15(b)(4)(C), may include a foreign court).

30/ *Investment Trusts and Investment Companies: Hearings Before a Subcommittee on the Senate Committee on Banking and Currency*, 76th Cong. 3d Sess. 7, 31, 559 (Statement of Honorable Charles F. Adams) (1940); *Investment Trusts and Investment Companies: Hearings Before a Subcommittee on the House of Representatives Committee on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 13, 46, 97 (1940). As to Section 15(b)(4)(B) of the Exchange Act (originally Section 15(b)(5)(B), *see* *Report to Accompany H.R. 6793*, H. Rep. No. 1418, 88th Cong., 2d Sess. 21 (1964).

31/ *In the Matter of R.P. Clarke & Co.*, 10 S.E.C. 1072 (1942). *See also*, L. Loss, *Securities Regulation* 1303, n. 51 (2d ed. 1961) (citing *R.P. Clarke* decision and stating that the Commission may impose sanctions under Section 15(b)(4)(B) based upon a conviction in a foreign court).

As to other provisions, however, such authority needs to be addressed. First, the Commission's authority to impose sanctions on a professional 32/ and to restrict association with a registered investment company 33/ for a misstatement in an application for registration or report filed with the Commission does not extend to misstatements made to foreign regulatory authorities. Second, the Commission's authority to impose sanctions on the professional 34/ to restrict association with a registered investment company 35/ for willful violation of the U.S. securities and commodities laws does not extend to violations of foreign securities laws. Finally, the Commission's authority to impose sanctions on professionals for aiding and abetting a violation or failing reasonably to supervise a person subject to the professional's control in violation of the U.S. securities laws 36/ and to restrict association with a registered investment company of personnel who are found to have aided and abetted such violations 37/ does not extend to activities that violate foreign securities and commodities laws. The legislation would provide the Commission with authority to act in each of these circumstances.

In addition, as to the provisions under which, as discussed above, the Commission has authority to impose sanctions, the legislation would make such authority explicit and would preclude certain challenges which might be possible under the existing statutes. In particular, Section 15(b)(4)(B) of the Exchange Act, Section 203(e)(2) of the Investment Advisers Act, and Section 9(a)(1) of the Investment Company Act refer to convictions for a "felony or misdemeanor" as the basis for a Commission sanction. A securities

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32/ *See* Section 15(b)(4)(A) of the Exchange Act and Section 203(e)(1) of the Investment Advisers Act.

33/ *See* Section 9(b)(1) of the Investment Company Act.

34/ *See* Section 15(b)(4)(D) of the Exchange Act and Section 203(e)(4) of the Investment Advisers Act.

35/ *See* Section 9(b)(2) of the Investment Company Act.

36/ *See* Section 15(b)(4)(E) of the Exchange Act and Section 203(e)(5) of the Investment Advisers Act.

37/ *See* Section 9(b)(3) of the Investment Company Act.

professional who was convicted in a country that does not define crimes as "felonies" or "misdemeanors" might successfully challenge the Commission's authority under these sections. A Commission administrative sanction also could be challenged when the foreign offense for which the securities professional was convicted is not one of the exact offenses specifically covered by the statutory provisions. As discussed below, the proposed legislation would undercut such defenses by providing for Commission sanctions based upon foreign convictions for crimes "substantially equivalent" to those listed in the statute. The legislation also would foreclose the potential argument that the statutory provisions 38/ that allow the Commission to impose sanctions on professionals who have been enjoined from acting in specific capacities, such as underwriters or investment advisers, do not apply to persons whose profession is not so defined in a foreign country. The proposed amendments would resolve the potential difficulties posed by differences in employment terms by permitting sanctions based upon an injunction entered against a professional who performs a "substantially equivalent" function to the activities currently listed in the statute.

The proposed legislation would also create a "statutory disqualification," as defined in Section 3(a)(39) of the Exchange Act, when a foreign securities authority or foreign court makes findings of illegal or improper conduct.

The Commission's action against a securities professional would not be automatic. The statutory procedure for imposing sanctions for foreign misconduct would be the same as that currently in place for imposing sanctions for domestic misconduct. The Commission would provide the securities professional with notice and an opportunity for a hearing prior to taking such action. The securities professional would thus have an opportunity to present evidence on his own behalf, in order to demonstrate that the imposition of sanctions would not be in the public interest. In addition, if the professional makes a persuasive due process or jurisdictional attack on the foreign adjudicative proceedings, the Commission may be required to permit relitigation of the underlying offense. In such a case, the foreign finding of misconduct would provide the basis for a Commission administrative proceeding even though principles of collateral estoppel might not be available to the Commission.39/

c. The proposed legislation

Title II of the proposed legislation would add new subsections 15(b)(4)(G) to the Exchange Act, 203(e)(7) to the Investment Advisers Act, and 9(b)(4) to the Investment Company Act. These provisions would apply the proscriptions of Section 15(b)(4)(A), (D), and (E) of the Exchange Act, Section 203(e)(1), (4), and (5) of the Investment Advisers Act, and Section 9(b)(1)-(3) of the Investment Company Act to an international context. Thus, the Commission would be able to impose sanctions on the professional if he has been found by a "foreign financial regulatory authority" -- a defined term in the Acts -- to have made false or misleading statements in registration statements or reports filed with the authority; violated foreign statutory or regulatory provisions regarding securities or commodities transactions; or aided, abetted, or otherwise caused another person's violation of such foreign securities or commodities provisions or failed to supervise a person who has committed a violation of such provisions. The term "foreign financial regulatory authority" would be defined in new Sections 3(a)(51) of the Exchange Act, 202(a)(24) of the Investment Advisers Act, and 2(a)(50) of the Investment Company Act to include a "foreign securities authority" or organization that is essentially equivalent to a self-regulatory organization. The term "foreign securities authority," in turn, is defined in new Sections 3(a)(50) of the Exchange Act, 202(a)(23) of the Investment Advisers Act, and 2(a)(49) of the Investment Company Act as "any foreign government or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws relating to securities." 40/

38/ Section 15(b)(4)(C) of the Exchange Act; Section 203(e)(3) of the Investment Advisers Act; and Section 9(a)(2) of the Investment Company Act.

39/ Similarly, in a Commission review, pursuant to 15 U.S.C. 19(d)-(f), of an SRO disciplinary or membership proceeding against a person subject to a statutory disqualification, the Commission might find it necessary to remand the proceeding to the SRO for relitigation of the underlying offense in cases where persuasive due process or jurisdictional challenges to the foreign proceeding are made.

40/ As noted (*supra* note 29), Section 15(b)(6) of the Exchange Act and Section 203(f) of the Investment Advisers Act authorize the Commission to limit activities of a person associated or seeking to become associated with a broker-dealer or investment adviser if the Commission finds that the person has committed any of the acts or has been convicted or enjoined as designated in Section 15(b)(4) or Section 203(e). Because

(continued...)

Subsections 15(b)(4)(G), 203(e)(7), and 9(b)(4) are substantially similar to the aforementioned subsections of 15(b)(4), 203(e), and 9(b). The most significant difference between the existing and the new provisions is that the legislation would not require that the foreign authorities find "willful" misconduct, i.e., a "willful" false filing, a "willful" statutory violation, or "willful" secondary liability. The Commission recommends this approach because of a potential disparity in standards of willfulness in different countries and because some countries may not require a "willful" violation. The proposed language would provide the Commission with flexibility in deciding whether the facts of a particular case warrant imposition of sanctions.

In addition, Section 15(b)(4)(B) of the Exchange Act and Section 203(e)(2) of the Investment Advisers Act would be amended to grant the Commission explicit authority to consider convictions by a foreign court of competent jurisdiction of any crime enumerated in current Section 15(b)(4)(B) and Section 203(e)(2) or a "substantially equivalent" foreign crime; Section 15(b)(4)(C) of the Exchange Act and Section 203(e)(3) of the Investment Advisers Act would be amended to state explicitly that the Commission may consider injunctions imposed by a foreign court of competent jurisdiction in connection with any of the activities designated in the statute, or a "substantially equivalent" foreign activity. The Commission would have authority to restrict association with a registered investment company based on the same factors in new subsections 9(b)(5) and (6).

It should be noted that the Commission would not recommend an amendment to Section 9(a) of the Investment Company Act, which prohibits association in certain capacities with a registered investment company by persons who have been convicted of certain offenses or who have been subject to specified injunctions. Section 9(a) is a self-policing mechanism, the purpose of which "is to prevent persons with unsavory records from occupying these positions where they have so much power and where faithfulness to the fiduciary obligations is so important." 41/ The automatic disqualification provisions of Section 9(a), coupled with the Commission's exemptive authority under Section 9(c) to avoid any inequitable results, are indispensable means of safeguarding the integrity of registered investment companies. However, due process concerns may be presented by legislation that would automatically bar a person solely on the basis of a foreign finding of a violation of foreign law, without any prior notice or opportunity for hearing by a U.S. court or administrative agency. These concerns are avoided if the Commission determines, on a case-by-case basis, whether the foreign finding justifies a bar, rather than relying exclusively on a foreign finding of a violation of foreign law. The amendment would not create any competitive disparities because, just as Section 9(a) applies equally to U.S. and foreign persons that have been convicted or enjoined in a manner specified in the statute, amended Section 9(b) would grant the Commission authority to institute an administrative proceeding against either a U.S. or foreign person that has committed an equivalent foreign violation and has been sanctioned by a foreign authority.

Finally, the Commission supports the proposed amendments to Section 3(a)(39). That section establishes the bases for imposing a "statutory disqualification" on a broker or dealer, thereby subjecting it to the possibility of disciplinary sanctions by the Commission or a self-regulatory organization as set forth in Section 15A(g)(2) of the Exchange Act and Rule 19h-1 thereunder. The proposed amendment would amend Section 3(a)(39) by creating a statutory disqualification for misconduct in foreign countries.

CONCLUSION

Internationalization of the U.S. securities markets has presented some of the greatest challenges to the Commission's efforts to protect the U.S. markets from fraud. The Commission believes that we have made great strides in developing mechanisms and approaches for policing the internationalized U.S. markets. The International Securities Enforcement and Cooperation Act of 1988 provides the authority necessary to build on the momentum we have been developing. We believe that it would provide a critical vehicle for enhancing our efforts to protect the internationalized U.S. securities marketplace.

40/ (...continued)
Title II requires the addition of new paragraphs in Section 15(b)(4) and Section 203(e), the legislation will provide for conforming amendments to Section 15(b)(6) and Section 203(f). Title II would also make conforming amendments to Sections 15B(c), 15C(c), 15C(f) and 17A(c) of the Exchange Act.

41/ Hearings on S. 3580 Before a Subcomm. of the Sen. Comm. on Banking and Currency, 76th Cong., 3d Sess. 46 (1940).

Senator RIEGLE. Thank you, Chairman Ruder. It was a very good statement.

Senator Hecht, did you have any comments you wanted to make?

Senator HECHT. No, Mr. Chairman.

Senator RIEGLE. Ms. Mochary, we are pleased to have you with us today, and I want to hear your testimony. I think we may begin the questioning of Chairman Ruder first, however, and run through some questions and then use that as a backdrop for your testimony.

First of all, Chairman Ruder, I'd like to ask you a few questions about this Wang-Lee case which just became public this last week.

First, what can you tell us about how this case was broken and how the Commission first became involved in the case?

Mr. RUDER. I'll try to.

Senator RIEGLE. And I'm wondering if Gary Lynch ought to join you. I know he's with you here.

Mr. RUDER. Yes, sir, if he'd like to come to the table that would be fine. My arrangement with him is that I will give to you the briefing that I've had from his office which consists entirely of public information; Mr. Lynch will not then be in the situation of having to worry about whether it's public or not public, although he knows full well in any event, and if I do not report it correctly or if you wish to have additional information, Mr. Lynch will be glad to indicate it to you.

Senator RIEGLE. Fine.

THE WANG-LEE CASE

Mr. RUDER. This case began with an observation by one of our staff attorneys of a newspaper article noting unusual trading in a company. We began an inquiry independently and subsequently we received information from four separate self-regulatory organizations which provided us with information about various accounts which were ultimately identified as having been those of Fred Lee.

Fred Lee is a Taiwan resident, but he has as well a home in Virginia. We identified his Virginia address and pursuant to a grant of authority from the Commission, the division began an investigation and looked at his telephone records; and ultimately we were able to identify Mr. Wang through the telephone records at Mr. Lee's McLean address.

Most of the trading through which this occurred was with Federated Investments Management—a U.S. broker-dealer, and we identified—there are several pieces of this which, I think, indicate our investigative techniques, and this is a most interesting one, as I was saying, we identified Mr. Orlando Lobo of Federated as one of the individuals whom we wanted to talk to. We then had what's called a "border watch" through the U.S. Customs. When Mr. Lobo was identified as coming into the country, we were able to trace his whereabouts and serve him with a subpoena. The subpoena on Mr. Lobo was effective because we were then able to take his testimony in the United States and it was his testimony that confirmed to us that the suspicious trading was indeed that of Mr. Lee.

We served a subpoena at Mr. Lee's McLean address and received a telephone call from him from Hong Kong in which his lawyer offered—in which he offered to testify pursuant to our request. We did take his testimony in Hong Kong and Mr. Lee through his lawyer confirmed that he had indeed been engaged in insider trading.

That essentially was how the matter was investigated and came to our deciding to bring a freeze order in the courts.

I may say, Senator Riegle, that normally in an investigative matter we would not be presenting this much public information, but since we did seek a freeze order here we were required to make information public.

Senator **Riegle**. I see.

Mr. **Ruder**. Do you want to say something, Gary?

Mr. **Lynch**. I guess there's just a couple of things I'd like to add.

Mr. Lee, as far as we know, is a Taiwanese national who is resident in Hong Kong. At least to one brokerage firm he's claimed Canadian citizenship, and we know that for certain periods during the last year he resided at a residence in McLean, VA.

The broker-dealer through whom much of the trading was done is Federated Investments Management, as the Chairman indicated. As far as we know, Federated Investments Management is a Hong-Kong broker-dealer. I'm not certain that they're registered in the United States. They are based in Hong-Kong, although I believe they are 100 percent owned by an American company.

Senator **Riegle**. It seems to me this case begins to illuminate the need for precisely the legislation that we have now put forward here and which you have endorsed today. We now have international trading arrangements going back and forth in ways that are not necessarily easy to keep track of, and the potential for abuse and illegal activity is self apparent.

I was struck by the fact that you said that the data had come up through four separate SRO's which threw the flag indicating that something might be amiss.

Should we take that to mean that the self-regulatory organization system seems to be working? At least it was working in this case, and it kicked up anomalies in trading data that caused you to have suspicions which you then pursued?

Mr. **Ruder**. Yes, that's true. I have visited several of the exchanges to look at their surveillance operations and I'm very pleased with what's going on in that area. We're getting good cooperation from them. We've been putting some pressure on them to give us faster reports, and we're trying to find ways particularly to get faster responses from the broker-dealer firms when the SRO's ask them for names of the persons engaged in the trading.

Senator **Riegle**. Can you indicate how many other similar situations there might be that have been flagged which you are now pursuing—where charges have not yet been brought but might be brought, and where you've got active inquiries under way based on this? Are we talking about very isolated rare events or are we talking about a few, or are we talking about a number of cases where you are out examining information that looks strange and that may in fact lead to disclosures such as we've seen last week?

OTHER CASES UNDER INVESTIGATION

Mr. **Ruder**. Mr. Lynch may want to respond to this in greater detail, but it's my understanding that we have substantial numbers of cases under investigation as a result of surveillance referrals from the exchanges.

Senator **Riegle**. Mr. Lynch, would you like to comment?

Mr. **Lynch**. Well, if the focus is on international trading, we have approximately somewhere between 40 to 50 investigations at the current time involving international trading.

Senator **Riegle**. And I gather we have no way of knowing the extent to which those could prove to be cases of considerable size, assuming action is brought? I mean I'm struck by the fact that I believe we've identified $19 million worth of illegal profits in this latest insider trading case, is that right?

Mr. **Lynch**. At least $19 million. It could be in excess of that.

Senator **Riegle**. Maybe more. Are some of these other cases you're looking at in terms of their potential size and scale, would they be in that range or are we talking about very large cases if they materialize or not?

Mr. **Lynch**. Well, they range in dollar amounts. At least one of the ongoing investigations involves very large dollar numbers. But they range in size down to $40,000 or $50,000 and even less than that.

Senator **Riegle**. I see. You indicated that there is something in excess of $40,000 for internationally connected cases under investigation. Could you give us a sense as to how many cases are being looked at that would be domestic in scope?

Mr. **Lynch**. I really can't even put a ballpark number on that. At any given time, the Commission has approximately 800 investigations underway, but many of those investigations wouldn't concern necessarily insider trading or a trading issue at all. It could be focusing on the filings that were made by an issuer. I really am not in a position now to give you a breakdown on trading cases that are currently underway.

Senator **Riegle**. I understand. I've been handed a note here that indicates that they've asked that we go to the floor to participate in a live quorum in advance of this vote.

Senator Shelby, before we do that, do you have a question you would like to pose?

Senator **Shelby**. I have an observation and then a question.

Mr. Chairman, I believe that you and the Commission have done an outstanding job on insider trading. It is my understanding that Mr. Lynch is going to continue to head your enforcement efforts.

WORKING WITH SWITZERLAND

I would like to ask you about the mechanics of working with the Swiss and difficulties that may arise from their bank secrecy laws. How do the Swiss assist with an investigation?

Mr. **Ruder**. We have two ways of dealing with the Swiss currently. The Swiss have signed a treaty on mutual assistance on criminal matters between the Swiss and the United States, and they have also exchanged diplomatic notes with us with regard to the use of that treaty.

We also have in existence an MOU with them which operates slightly differently and more informally. The diplomatic notes provide that at such point as the Swiss insider trading law becomes effective, the primary method of obtaining information from the Swiss will be through the treaty.

But we use the treaty and the MOU's together to obtain information from the Swiss despite the existence of the bank secrecy laws, and it's working. It is working very well.

I may say that in connection with this very case, the Lee-Wang case, we have learned that there has been trading from Switzerland and that we are in active cooperation with the Swiss to obtain further information and, if possible, to freeze assets over in Switzerland. That's an active negotiation now underway.

Senator SHELBY. Luxembourg is becoming a big international banking area. What are you doing there? You don't have an agreement with them, do you?

Mr. RUDER. We do not have an agreement with them, that's right.

Senator SHELBY. Do you have to just deal on what information you can dig up?

Mr. RUDER. We have to deal with them on a case-by-case, ad hoc basis and do the best we can.

Senator SHELBY. Haven't the banks in Luxembourg been picking up the slack, gaining a lot of business, so to speak, from banks in various countries because of their secrecy laws?

Mr. RUDER. I don't have information about that that I can give you from my own knowledge. I know that one can expect that there will be illegal activities conducted in countries where cooperation is not available with us as easily.

Senator SHELBY. But the basic message, I would hope, is that people aren't going to be able to hide in Switzerland or anywhere else behind the so-called bank secrecy laws, that you're going to get them wherever you can find them, right?

Mr. RUDER. We are. And I think the interesting event is that since we have been pursuing these MOU agreements in the major markets we are gradually limiting the number of jurisdictions in which a criminal can expect to engage in these activities without our being able to find him. And at least in my view, the passage of this law, permitting us the power to obtain and investigate here and to seek reciprocal agreements abroad will be very, very helpful for us.

Senator SHELBY. Thank you.

Mr. Chairman, thank you. I know we have a vote.

Senator RIEGLE. Thank you, Senator Shelby.

Let me ask you, in light of this latest major insider trading case that's just been brought, do you think that additional penalties are needed to deter insider trading, much tougher penalties? And what additional precautions, if any, do you think that investment banking firms have to take to ensure compliance with the law and stop or do a better job of attempting to stop violations like this in the future?

Mr. RUDER. With regard to the increased sanctions and penalties, I think the answer to that question really requires greater effort in the criminal area through the U.S. attorneys, and we have urged frequently that the Justice Department allocate more resources to insider trading and securities law matters.

I think the penalties are strong enough. We have a 5-year criminal sanction for this activity, and that's a very large number of years for a white collar criminal to face.

Senator SHELBY. Mr. Chairman, would you yield?

Senator RIEGLE. Yes.

Senator SHELBY. Mr. Chairman, what is the Commission's budget for the enforcement division? Has it been increased in the last several years as the insider trading cases have increased?

Mr. RUDER. I could do it by staff numbers rather than dollars.

Senator SHELBY. Just a rough estimate.

INCREASE OF ENFORCEMENT PERSONNEL

Mr. RUDER. We have increased the number of staff over the past 3 years or so—Gary has these numbers more clearly than I do, but from something like 500 positions to something like 600 positions.

Mr. LYNCH. Actually, it's approximately 600 positions to over 700 positions, as of the time that the new hires that we made recently join us in August and September.

Senator SHELBY. And accordingly, your budget has increased. That's logical.

Mr. RUDER. Well, the budget has increased in the enforcement division, but it has only been in the 1988 budget that we were given significant resources to increase our budget generally.

Senator SHELBY. Thank you, Mr. Chairman.

Senator RIEGLE. Let me ask you this. Do you have what you need?

Mr. RUDER. In my view, we do not.

Senator RIEGLE. How much more do we need?

Mr. RUDER. It's hard to quantify, but I would want to have another 50 or so staff people added to the enforcement division. I may say the priorities in the Commission are so strong in other areas that my budgetary allocation has been that, if I have to choose, I have to increase the investment management and market regulation staff.

Senator RIEGLE. Mr. Lynch, let me ask you—you're over on the enforcement side. If we were going to really do this job the way we ought to do it, how many more people would you think are needed?

Mr. LYNCH. Well, we could easily increase our staff by 50 to 60 people over the next year and keep them extremely busy.

Senator RIEGLE. In other words, you've got work waiting for them to do.

Mr. LYNCH. Or we could staff our cases more fully than we're currently staffing them.

Senator RIEGLE. Would that mean you would move them faster?

Mr. LYNCH. I believe we would move them faster. I should make it clear that you could triple our staff and we still would have to make decisions as to which cases to pursue and which ones not to pursue.

Senator RIEGLE. We're not here to try to figure out how to just increase it. We're trying to decide whether you're short-handed in the face of a growing problem.

Mr. LYNCH. I think with the problems we're facing, an increase in staffing in the home office alone of 50 to 60 people over a year period and gradually adding an additional 50 to 60 people would certainly increase our effectiveness.

Senator RIEGLE. And as you say, Mr. Chairman, you would probably like to do that but the budget pressures for the Commission as a whole are so severe that you've got shortages in other areas as well that you really aren't in a position to respond to. Is that an accurate statement?

Mr. RUDER. That's correct. And I am worried, as I have indicated to some, about what may happen in the budget process that's going on now.

I may say one of the things we should recognize is the increased large case litigation load that we have. Some of these cases in the professional area are very, very complicated and involve the allocation of tremendous resources by the defendants in these cases, and they are putting us to a test in terms of personnel that way.

Senator RIEGLE. Let me indicate I'm going to have to recess the committee. We will have two back-to-back votes. Then we're going to be followed by a cloture vote and I would think that that would mean that it will be roughly 20 minutes or so before I'm able to come back. So I would like everyone to know that they've got at least that period of breathing space and I will return as quickly as I can.

The committee stands in recess.

[Recess.]

Senator RIEGLE. The committee will come back to order. I apologize again for the delay.

I have really three additional questions that I'd like to go through rather quickly, Chairman Ruder, and then we want to go to our other witness. I'm going to give you some additional questions for the record beyond that.

OBTAINING INFORMATION FROM ABROAD

Turning to the legislation that's before us, let me ask you, what kind of problems have you run into in the past in obtaining information from abroad which you thought was necessary for a significant case that you wanted to bring in the United States?

Mr. RUDER. I would prefer to have Mr. Lynch answer that question. It's quite fact specific, and he would be able to answer it better than I.

Senator RIEGLE. Mr. Lynch.

Mr. LYNCH. Well, any time that we want to obtain information from abroad we're faced with difficulties and our approach to this problem has generally been to pursue it by a cooperative, nonconfrontational approach with other countries. To the extent that we can enter into memoranda of understanding with other countries, pursuant to which we can offer to do investigations in the United States on their behalf, we believe that we're going to be in a better position to get a similar agreement from them.

At the current time, if we wanted to get information from the United Kingdom, for example to turn to a specific country, the Department of Trade and Industry in the United Kingdom is obliged to use their best efforts to gather information that's responsive to our request.

If we're interested in the trading of a citizen of the United Kingdom who's not a broker-dealer in the United Kingdom but just a businessman, and that person does not want to provide United Kingdom authorities with an explanation as to why he purchased a certain security in the United States, we really have no effective way of obtaining that kind of information.

It's really difficult for us to complain about that situation now in our dealings with other countries because we can't compel people to provide that information to us to assist their inquiries. We just feel that with this legislation we're going to be in a much better position to negotiate more effective understandings.

Senator RIEGLE. Have there been any major investigations that you wanted to pursue or were pursuing that were stalled or delayed or even ultimately discontinued on the basis of a lack of foreign cooperation?

Mr. LYNCH. Well, there are cases that are stalled and I'm certain there are cases that have been closed in the past because we haven't been able to obtain information from outside of the United States, certainly.

Senator RIEGLE. Do we have major cases that are stalled?

Mr. LYNCH. At the current time, the major cases that I can think of in the international area are progressing. Some of them a little more slowly than I would like, but they are all progressing.

Mr. RUDER. If I may just add one answer to that, we do have an investigation underway in Canada in the province of Quebec. The name of it is not public but the fact of it is, in which Quebec is using the power of the type that we seek here in Quebec. That's the one jurisdiction which does have the power to use their compulsory process in our investigation, and they are cooperating with us to assist our investigation there.

The proposition really is tied up with the fact that there may be activity which violates our laws but doesn't violate the laws of a particular foreign country, and it's in that circumstance that we want to have their compulsory power available to us.

Senator RIEGLE. Are there any particular countries that should be noted as being least cooperative?

Mr. RUDER. My answer to that question would be that we have obtained, when we have needed it, cooperation from the major markets. That is, in Great Britain, in Switzerland, in Japan when we've needed it, and in Canada, we have had strong cooperation from the authorities.

There are situations in which that cooperation is not as forthcoming as we would like, but I'm not able to identify them here, and I haven't had discussions with Gary in which we have pointed to say "x" country as the one from which we're not getting any cooperation at all.

Senator RIEGLE. Are there some countries, Mr. Lynch, that are quite uncooperative and are really problems in that respect?

Mr. LYNCH. Well, certainly some countries are less cooperative than other countries. There's no question about that. I do think that even the countries that are less cooperative are starting to appreciate the benefits that can be achieved for their country as well as the United States and for the world's markets if there is better cooperation between countries.

If you look at the change in approach throughout the world in the last 3 or 4 years, there's really been a significant turnaround in many countries. While 3 or 4 years ago the initial reaction was to view this, if there was trading in the U.S. markets that was a problem, it was to view it solely as a U.S. problem and now other countries seem to be taking a much more cooperative approach, even those countries that I would still view as less cooperative than others. I'm reluctant to identify those countries.

Senator RIEGLE. Well, I don't know that we necessarily need you to identify countries by name, but let me just use an analogy. We know, for example, in terms of international drug traffic that there are some countries in which a lot of levels of leadership are involved, or so it seems, in drug trafficking. And as we've tried to crack down on that, the case in Panama today is front page news, but there are others.

I am concerned that there are other countries that are not being sufficiently cooperative in this area and that they in effect become havens for people who want to become violators or exploiters of the laws with respect to international securities trading.

RECIPROCAL ARRANGEMENTS

So my concern would be, while the main focus of what we're talking about here is to set up reciprocal arrangements where we can get information back and forth to stop these illegal practices, if there are in a sense countries that do not want to move in that direction and in effect become sort of the example of what we would like to see prevented, I'd like to know about that. I would hope that at some point those kinds of things, if they exist or if they appear to be starting to exist, would be brought to our attention.

Mr. LYNCH. Well, this legislation is going to be very helpful if it becomes law with respect to those countries that want to be cooperative. There's likely to be some countries who won't see it in their interest to be cooperative and I think with respect to those countries in appropriate cases we have to always be willing to take unilateral action, as we did back in the early 1980s in several cases, and go to court in the United States and freeze assets of foreign banks or brokers in order to obtain cooperation.

While the major thrust of our program is to enter into cooperative agreements and to be nonconfrontational, I think we recognize that there may be situations where we will have very little choice but to take unilateral action.

Mr. RUDER. I may add, Senator Riegle, that at the International Organization of Securities Commissions level, we presented a resolution seeking agreement to this proposition of reciprocal or cooperative arrangements, and 23 members of that organization have signed such an agreement. And those 23 members include a very large proportion of the trading markets in the world. So we're seeing much more of a cooperative attitude from these countries than we are attitudes of obstruction.

Senator RIEGLE. It seems to me, too, in effect, that what can happen here is that foreign people who are conducting illegal insider trading activity can steal money from American shareholders. In other words, it's an international trading loop. If there is insider trading going on in American Securities and people are being cheated out of value because of inside information, that's like a theft of money from shareholders in the United States. The money, in turn, goes into the pockets of somebody who is a native of Taiwan or some other country around the world.

I think as the world trading system has gone through these massive changes in the last few years, we're still struggling to catch up with what the reality is and it seems to me this legislation helps very materially in that respect.

If countries identify themselves as countries which are least cooperative and become havens for people who want to conduct improper international securities operations, I would like to make sure that we know that so we can come after them in a variety of ways.

Mr. RUDER. I think that's a very fine point, sir, and we will take steps to identify those countries and perhaps be able to come back to you for your cooperation and assistance to see if we can't get at them in some other way.

Senator RIEGLE. I have just two other things and then I want to go to our other witness. I'll give you some questions for the record.

With respect to precautions against insider trading, I'm wondering, do investment banking firms and entities that have material inside information need to take additional steps to safeguard this information so that those that would misuse it find it harder and harder to get their hands on that kind of data?

Mr. RUDER. The Commission has been quite active in insisting that broker-dealer firms and investment bankers who may be in possession of inside information because of their deal making create effective Chinese walls—that is separations between their mergers and acquisitions departments and their trading departments—so that the information does not go from one side of the firm to the other. We are continually and actively in cooperation with the SRO's or self-regulatory organizations, the exchanges, and the broker-dealer firms to see that effective measures are in place. Our inspection programs are reviewing or attempting to review those arrangements.

Senator RIEGLE. From what I've read in the newspaper about the current case, it's hard for me to understand how the pattern of insider trading could have gone on so long in so many different instances and not have come to light. I mean not have come to light by internal surveillance mechanisms.

Are you surprised at that?

Mr. RUDER. We're looking at that very carefully. What we have seen is that the trading in Mr. Wang's company—one of the things we were able to identify was that the transactions were ones in which his firm was engaged, and the fact that there were or may have been trading transactions in Mr. Lee's accounts or nominee accounts in that very firm is a very serious question for us to look at.

We think in all cases the first level of responsibility here is at the broker-dealer level, and they should be reviewing their own records on a constant basis to see that this kind of activity is not taking place.

Senator **Riegle**. Yes. I think we've all tended to operate on the assumption that the internal safeguards would be such that if there were a pattern of advance trades seemingly based on confidential information occurring, presumably even in the same firm, that that would come to light quite quickly, that the internal systems ought to be geared in such a way as to flag those things almost immediately. It appears in this case—and, of course, we don't yet have all the facts—that for a very long period of time apparently at least $19 million worth of illegal trading profits occurred over a series of trades in about 20 different takeover situations.

Mr. **Ruder**. But not all the trading, as we understand it, occurred in the same firm. There were three or four.

Senator **Riegle**. I see. Some did and some did not.

Mr. **Ruder**. Some did not. There were other firms in which the trading was taking place.

Interestingly enough to me, there was it seems a deliberate attempt to hide this activity, but mistakes were made, and eventually those mistakes led to the uncovering of this activity through our investigative work.

Senator **Riegle**. Now the legislation that we've introduced requires that before the Commission provides a foreign country with assistance that the other country has to agree to provide us with "similar assistance." In other words, we lay out a reciprocal or reciprocity test here and we leave it I think general enough with that use of "similar assistance" to provide some room for interpretation there.

But you disagree with this provision and you've stated that the Commission believes this requirement could restrict its ability to provide such assistance in cases where such assistance would be in the interest of both foreign and U.S. investors alike.

Now I understand and will hear very, very shortly from our State Department witness that they agree with the reciprocity language that we've laid out.

So can you throw some more light on why you dissent on that issue, particularly in light of the fact that the State Department would agree with our contention?

Mr. **Ruder**. Well, I may say, sir, it's not a live or die matter for us. Even in our debates about this legislation within the Commission, we asked ourselves the question of whether the reciprocal provision should be mandatory or merely a factor. The way our legislation was drafted was we made it a factor that the Commission should consider in deciding whether to enter into one of these agreements rather than making it a mandatory provision.

Our thinking was that there may be situations—two kinds of situations which would be important to us. One would be a situation in which we're not able to get an agreement to this effect from a foreign jurisdiction, and that we might demonstrate to them by using this power in the United States on sort of a test or trial basis the benefits which the foreign jurisdiction could have, and that in that circumstance it would lead us to better bargaining and a stronger bargaining position in getting that kind of MOU on a reciprocal basis eventually agreed to.

The second one is a situation in which there really is a U.S. interest in the activity which exists overseas, an interest which we would like to facilitate by cooperating in the investigation of a foreign government in the violation of its own laws. And that our cooperation and use of our subpoena power would be one which we as an agency thought was beneficial and they may not have such a reciprocal agreement in existence and therefore we wouldn't be able to use our power when in effect we thought we should.

Senator **Riegle**. Well, my own view is—and I've heard what you've said and I'm willing to consider it further—that we have to try to get off on an equivalent footing here. I think if this is going to work and we're going to move in new ways to find information and deliver it to foreign governments, we can't be on an unequal footing where they're saying, "Thank you very much, but don't ask us to do the same thing."

We are in the modern age. I think governments have to look at these things in a serious way and if we're going to be able to have a working relationship I think we've got to be on an equivalent footing.

I would think it would be unusual to find a country that would not be willing to move to that position. If not, I'd like to know about it. I don't want there to be places around the world that become attractive places for people to go and feel that somehow they can abuse the international securities trading system and in a sense have a certain protection for illegal activity because they're doing it from a particular country. I think if countries don't want to adhere to some kind of a reasonable set of common rules of the game in tracking down illegal activity, we need to know about that. So I'm not terribly sympathetic about somebody that wants to operate on a different footing.

In any event, we can maybe leave that point now, and we'll decide that issue as we go down through the legislation. I'm glad you said it's not a live or die issue as you see it.

I'm going to give you some additional questions for the record. Do either of you have another comment you want to make before we move on?

Mr. **Ruder**. I just have one that I think is quite important; in the insider trading area, we are finding foreign jurisdictions being more aware of the negative aspects of insider trading, and quite recently I received a letter from the Director of the Securities Bureau in Japan informing me that Japan has adopted now their insider trading legislation. I think as this conduct becomes illegal in more and more markets, we're going to see greater cooperation between our country and theirs in this area.

Senator **Riegle**. Good. I hope that's right. Let me thank you both for your testimony and for your work and let me excuse you now.

Ms. Mochary, have you testified before either before the Senate or the House?

Ms. **Mochary**. Yes, sir.

Senator **Riegle**. So you're accustomed then to delays like this which sometimes occur when votes take place. So I appreciate your patience, and we're pleased to hear from you now.

STATEMENT OF MARY V. MOCHARY, PRINCIPAL DEPUTY LEGAL ADVISER, U.S. DEPARTMENT OF STATE

Ms. MOCHARY. Thank you very much. I appreciate the opportunity to appear before you today.

I would like to submit my written statement for the record and, with your permission, make my oral presentation somewhat shorter.

Senator RIEGLE. Please do. We will make your statement a part of the record.

Ms. MOCHARY. Mr. Chairman, I am pleased to appear before the subcommittee today on behalf of the Department of State in support of Senate bill 2544. My comments focus on the foreign policy aspects raised by title I of the legislation.

The administration is continuing its review of other provisions of this bill. I anticipate that additional comments from the administration will be provided to the committee very shortly.

[See statement from Justice Dept., p. 7 .]

The increasing internationalization of the securities markets has created new opportunities for persons to engage in fraudulent activity on an international scale. It has also created a corresponding need for the development of new law enforcement tools to protect U.S. markets from that fraudulent activity, particularly with respect to the collection of evidence abroad.

We believe that the proposed legislation would provide several such tools permitting closer cooperation between the Securities and Exchange Commission and its foreign securities enforcement counterparts.

I will speak to express the view of the Department of State that this legislation is in the foreign policy interest of the United States. One of the more difficult and potentially contentious areas in the field of international law enforcement is the collection of evidence in a foreign country. A basic principle of international law is that the law enforcement function within a State is totally reserved to that State. Generally, other States can pursue law enforcement activities on that State's territory only by consent.

Therefore, when a defendant or a witness in an investigation declines to comply with a request to produce documents or testimony which is located abroad, the options for a U.S. investigator are quite limited.

EXPLANATION OF UNILATERAL ENFORCEMENT

One such option is to use unilateral enforcement measures. We've heard the term used quite often this morning, but I would like to explain what it means. A foreign bank has bank records to which a U.S. investigator would like to have access. The foreign bank, which is not a target of the investigation, has a branch in the United States. An employee of the U.S. branch of the bank is ordered by a U.S. court to produce the required records. When the branch officer does not produce the records requested, he is held in contempt for his bank's failure to provide documents which are only available outside of the United States.

The concerned foreign government may view the threat or imposition of sanctions against the U.S. branch officer to coerce the home office into producing the records as an objectionable exercise of extraterritorial jurisdiction.

In some such cases, particularly in civil law countries, the applicable foreign law may actually restrict or even prohibit disclosure of the requested information by the person or entity from whom it is sought.

Understandably, many foreign governments take exception to attempts by U.S. law enforcement authorities to require their nationals to violate their laws, particularly with respect to documents and information located within their territory.

The potential for creating a major irritant in our bilateral relations is clearly present. Such conflicts do not arise frequently, but when they do they can have serious and often unnecessary repercussions.

It has been the experience of the Department of State that these difficulties can be managed better, and often avoided altogether, by approaching matters on a cooperative rather than confrontational basis and by agreeing with foreign governments in advance on a formal procedure for handling requests for information located in their territory.

NEGOTIATE BILATERAL MUTUAL ASSISTANCE TREATIES

For this reason, Mr. Chairman, it has been one of this administration's priorities in the area of international criminal law enforcement to negotiate bilateral mutual assistance treaties with those countries with which such difficulties have most often arisen in the past.

Four such treaties are now in force and six more are currently pending before the Senate Foreign Relations Committee. We hope that advice and consent to ratification of those six treaties will be forthcoming in the near future. They provide important law enforcement tools and mechanisms which protect U.S. interests by helping to avoid confrontational situations.

The SEC has been able to benefit from the existence of these mutual legal assistance treaties. However, for rather technical reasons, the MLAT's [Mutual Legal Assistance Treaties] have not provided as broad a range of assistance as the Commission believes is desirable.

Part of the reason lies in the fact that the Commission's investigations are not always criminal or viewed as criminal. As a result, the Commission has, over the past few years, negotiated a number of bilateral agency-to-agency agreements directly with those foreign countries' securities enforcement authorities, both to enhance the level of cooperation and to provide an effective alternative to unilateral enforcement measures.

The Department of State has worked closely with the Commission in the development and approval of these agreements. In our view, these bilateral arrangements help the Commission to obtain information from abroad. They also provide a framework for future cooperation and an incentive to other governments to enter into similar arrangements with us.

We believe the legislation before the subcommittee today would endorse this approach by providing a clear statutory basis for increased cooperation between the Commission and foreign securities authorities. More specifically, it would enable the Commission to require persons or entities here to produce evidence relating to a potential violation of foreign securities laws, if the SEC's foreign counterpart agrees to provide similar assistance at the request of the Commission. Such investigations would be done at the SEC's discretion and in compliance with U.S. laws.

The Department of State believes this is the correct approach to take. We would expect to work closely with the Commission, both in the negotiation of such agreements and in respect of given requests to and from foreign authorities pursuant to those agreements.

RECIPROCITY REQUIREMENTS

I note the SEC's concern over the bill's requirement of reciprocity on the ground that it is unnecessarily restrictive and would limit the Commission's ability to provide assistance to foreign authorities even when doing so would advance the goal of protecting U.S. markets. The State Department believes that cooperation in this area should be reciprocal and that our law enforcement authorities should always be able to obtain as much assistance from their foreign counterparts as they are willing to provide to those counterparts.

We believe that a reciprocity requirement can serve as an inducement to foreign governments to participate with U.S. law enforcement authorities on a close and productive basis.

The remainder of title I of the proposed legislation would facilitate implementation of such agreements by enabling the Commission to provide confidential treatment to nonpublic information provided by foreign governments and making explicit its ability to adopt rules for sharing evidence with other securities officials, foreign and domestic.

The Department of State believes these provisions are consonant with the cooperative approach I have discussed.

Because title II of the bill really concerns the regulation of domestic markets, Mr. Chairman, the Department takes no position on those provisions.

Thank you for providing me the opportunity to give you the views of the Department of State.

[The complete prepared statement of Ms. Mochary follows:]

TESTIMONY OF
MARY V. MOCHARY
PRINCIPAL DEPUTY LEGAL ADVISER
U.S. DEPARTMENT OF STATE
BEFORE THE SUBCOMMITTEE ON SECURITIES
OF THE SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

CONCERNING S. 2544
"INTERNATIONAL SECURITIES ENFORCEMENT
COOPERATION ACT OF 1988"

JUNE 29, 1988

Mr. Chairman:

I am pleased to appear before the Subcommittee today on behalf of the Department of State in support of S. 2544, the "International Securities Enforcement Cooperation Act of 1988", which would amend the federal securities laws to facilitate cooperation between the United States and foreign countries in the field of securities law enforcement. My comments address the foreign policy aspects raised by Title 1 of the legislation. The Administration is continuing its review of this bill's provisions. I anticipate that additional comments from the Administration will be provided to the Committee in the near future.

The increasing internationalization of the securities markets has created new opportunities for persons to engage in fraudulent activity on an international scale. It has also created a corresponding need for the development of new law enforcement tools to protect U.S. markets from that fraudulent activity, particularly with respect to the collection of evidence abroad. We believe that the proposed legislation would provide several such tools permitting closer cooperation between the Securities and Exchange Commission and its foreign securities enforcement counterparts.

Chairman Ruder has explained the particular challenges faced by the SEC in its international enforcement efforts, as well as the responses it has made and the reasons why, from the Commission's viewpoint, the additional statutory authority which S. 2544 would provide is required. I will speak to express the view of the Department of State that this legislation is in the foreign policy interests of the United States. I reiterate that the Administration has not yet taken a position on the bill and is continuing to review the proposal.

One of the more difficult and potentially contentious areas in the field of international law enforcement is the collection of evidence in a foreign country. A basic principle of international law is that the law enforcement function within a state is totally reserved to that state. Generally other states can pursue law enforcement activities on that state's territory only by consent. Therefore when a defendant or the witness in an investigation declines to comply with a request to produce documents or testimony which is located abroad, the options for a U.S. investigator are quite limited. One such option is to use Unilateral Enforcement Measures. I will explain what that means: a foreign bank has bank records to which a US investigator would like to have access. The foreign bank, which is not a target of the investigation, has a branch in the United States. An employee of the US branch of the bank is ordered by a US court to produce the required records. When the branch officer does not produce the records requested he is held in contempt for his bank's failure to provide documents which are only available outside the United States. The concerned foreign government may view the threat or imposition of sanctions against the U.S. branch officer to coerce the home office into producing the records as an objectionable exercise of extraterritorial jurisdiction. In some such cases, the applicable foreign law may actually restrict or even prohibit disclosure of the requested information by the person or entity from whom it is sought. This is often the case, for example, where foreign bank secrecy or blocking laws apply. Understandably, many foreign governments take exception to attempts by U.S. law enforcement authorities to require their nationals to violate their laws, particularly with respect to documents and information located within their territory. The potential for creating a major irritant in our bilateral relations is clearly present.

Such conflicts do not arise all that frequently, but when they do they can have serious - and often unnecessary - bilateral repercussions. It has been the experience of the Department of State that these difficulties can be managed better, and often avoided altogether, by approaching matters on a cooperative rather than confrontational basis, and by agreeing with foreign governments in advance on a formal procedure for handling requests for information located in their territory.

For this reason, Mr. Chairman, it has been one of this Administration's priorities in the area of international criminal law enforcement to negotiate bilateral mutual legal assistance treaties with those countries with which such difficulties have most often arisen in the past. Four such treaties are now in force, and six more are currently pending before the Senate Foreign Relations Committee. We hope that advice and consent to ratification of those six treaties will be forthcoming in the near future. They provide important law enforcement tools and mechanisms which protect U.S. interests while helping to avoid confrontational situations.

To some extent, the SEC has been able to benefit from the existence of the mutual legal assistance treaties. As Chairman Ruder has explained, however, for rather technical reasons the

MLATs, AS THEY ARE KNOWN, HAVE NOT PROVIDED AS BROAD A RANGE OF ASSISTANCE AS THE COMMISSION BELIEVES IS DESIRABLE. PART OF THE REASON LIES IN THE FACT THAT THE COMMISSION'S INVESTIGATIONS ARE NOT ALWAYS CRIMINAL, OR VIEWED AS CRIMINAL, FOR INSTANCE WHEN EQUITABLE RELIEF IS SOUGHT, AND THAT CAN BE A PROBLEM WHEN DUAL CRIMINALITY IS REQUIRED. ANOTHER PART LIES IN THE DIFFERENT WAYS IN WHICH FOREIGN JURISDICTIONS STRUCTURE THEIR SECURITIES LAW ENFORCEMENT AUTHORITIES. AS A RESULT, THE COMMISSION HAS OVER THE PAST FEW YEARS NEGOTIATED A NUMBER OF BILATERAL AGENCY-TO-AGENCY AGREEMENTS DIRECTLY WITH THOSE FOREIGN SECURITIES ENFORCEMENT AUTHORITIES, BOTH TO ENHANCE THE LEVEL OF COOPERATION AND TO PROVIDE AN EFFECTIVE ALTERNATIVE TO UNILATERAL ENFORCEMENT MEASURES. CHAIRMAN RUDER HAS DESCRIBED THESE AGREEMENTS TO YOU, IN PARTICULAR THE AGREEMENT REACHED EARLIER THIS YEAR WITH CANADIAN PROVINCIAL SECURITIES AUTHORITIES, AND THOSE REACHED EARLIER WITH AUTHORITIES IN SWITZERLAND, THE UNITED KINGDOM AND JAPAN.

THE DEPARTMENT OF STATE HAS WORKED CLOSELY WITH THE COMMISSION IN THE DEVELOPMENT AND APPROVAL OF THESE "MEMORANDA OF UNDERSTANDING". IN OUR VIEW, THESE BILATERAL ARRANGEMENTS ENHANCE THE ABILITY OF THE COMMISSION TO OBTAIN INFORMATION FROM ABROAD IN A RELIABLE AND PREDICTABLE MANNER WHILE AVOIDING INTERGOVERNMENTAL DISPUTES AND CONFLICTS. THEY ALSO PROVIDE A FRAMEWORK FOR FUTURE COOPERATION AND AN INCENTIVE TO OTHER GOVERNMENTS TO ENTER INTO SIMILAR ARRANGEMENTS WITH US. AS A PRACTICAL MATTER, THE MOUs ARE FLEXIBLE, ALLOWING THE COMMISSION TO RESPOND MORE EFFECTIVELY TO AN EVOLVING INTERNATIONAL MARKET.

WE BELIEVE THE LEGISLATION BEFORE THE SUBCOMMITTEE TODAY WOULD ENDORSE THIS APPROACH BY PROVIDING A CLEAR STATUTORY BASIS FOR INCREASED COOPERATION BETWEEN THE COMMISSION AND FOREIGN SECURITIES AUTHORITIES. MORE SPECIFICALLY, IT WOULD ENABLE THE COMMISSION TO CONDUCT WITHIN THE UNITED STATES INVESTIGATIONS OF SECURITIES FRAUD ON BEHALF AND AT THE REQUEST OF FOREIGN AUTHORITIES, I.E., TO REQUIRE PERSONS OR ENTITIES HERE TO PRODUCE EVIDENCE RELATING TO A POTENTIAL VIOLATION OF FOREIGN SECURITIES LAWS, IF THE SEC's FOREIGN COUNTERPART AGREES TO PROVIDE SIMILAR ASSISTANCE AT THE REQUEST OF THE COMMISSION. SUCH INVESTIGATIONS WOULD BE DONE AT THE SEC's DISCRETION AND IN ACCORDANCE WITH U.S. LAW.

THE DEPARTMENT OF STATE BELIEVES THIS IS THE CORRECT APPROACH TO TAKE. WE WOULD EXPECT TO WORK CLOSELY WITH THE COMMISSION BOTH IN THE NEGOTIATION OF SUCH AGREEMENTS AND IN RESPECT OF GIVEN REQUESTS TO AND FROM FOREIGN AUTHORITIES PURSUANT TO THOSE AGREEMENTS.

I note the SEC's concern over the bill's requirement of reciprocity, on the ground that it is unnecessarily restrictive and would limit the Commission's ability to provide assistance to foreign authorities even when doing so would advance the goal of protecting U.S. markets. The State Department believes that cooperation in this area should be reciprocal, and that our law enforcement authorities should always be able to obtain as much assistance from their foreign counterparts as they are willing to provide to those counterparts. We believe that a reciprocity requirement can serve as an inducement to foreign governments to participate with U.S. law enforcement authorities on a close and productive basis.

The remainder of Title I of the proposed legislation would facilitate implementation of such agreements by enabling the Commission to provide confidential treatment to nonpublic information provided by foreign governments and making explicit its ability to adopt rules for sharing evidence with other securities officials, foreign and domestic. The Department of State believes these provisions are consonant with the cooperative approach I have discussed. Because Title II of the bill really concerns regulation of domestic markets, Mr. Chairman, the Department takes no position on its provisions.

Thank you for providing me the opportunity to give the views of the Department of State.

Senator **Riegle**. Thank you very much. I want to say I appreciate the State Department's unqualified support for the legislation. I think you make a strong case, particularly on the reciprocity aspect which we were discussing earlier.

Are there any other specific legislative steps that you think we ought to be taking to improve international law enforcement in the securities area? I don't spring that question on you as if you would necessarily have a long list of things, but are there some other things that you would urge us to think about or take a look at that perhaps ought to be done in addition to what we are proposing here?

Ms. **Mochary**. The Mutual Legal Assistance Treaties that I mentioned are a very important part of the cooperation in the securities area because they give the underlying framework and giving Senate advice and consent to those treaties would be a very significant step.

Senator **Riegle**. Anything else?

Ms. **Mochary**. Not that I can think of right now.

Senator **Riegle**. OK. I understand that you have a letter from John Whitehead on this subject. Is that correct?

Ms. **Mochary**. Yes, I do.

Senator **Riegle**. Could you read that to us? Is it very long?

Ms. **Mochary**. It's three paragraphs.

Senator **Riegle**. Why don't you just read it to us.

Ms. **Mochary**.

> Dear Mr. Chairman: While I regret that I am unable to appear before your Subcommittee today, I would like to express my support for the principle underlying S. 2544, the "International Securities Enforcement Cooperation Act of 1988", and our appreciation to you for today's hearing on this proposal.
>
> Legislation of this type will assist cooperative efforts on an international level to regulate the securities markets. The increasing internationalization of those markets makes such enforcement cooperation essential, especially with our closest allies and principal trading partners.
>
> As you know, before becoming Deputy Secretary of State, I spent 38 years in investment banking on Wall Street. I believe I can speak with some considerable experience, therefore, when I say that legislation of the sort now before the Subcommittee is important from both the securities regulation and foreign policy perspectives. In my view it will not only promote better law enforcement cooperation with our friends, it will help protect Americans trading in U.S. markets from foreign-based fraud and promote the kind of fair securities markets we want to see develop around the world. Sincerely, John C. Whitehead.

Senator **Riegle**. Thank you. I appreciate the testimony that you've given today and we may have questions for you as well for the record from other members that are not able to be here this morning. But I appreciate the testimony. I think it's been helpful and I think it puts us in a position to move ahead.

Ms. **Mochary**. Thank you.

Senator **Riegle**. I want to thank you.

The committee stands in recess.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

[Response to written questions and additional material for the record follows:]

Questions for Mr. Ruder from Senator Proxmire from June 29, 1988

Q.1 Ms. Mochary of the State Department who will testify later this morning states on page 4 of her prepared testimony that "the State Department believes that cooperation in this area should be reciprocal and that our law enforcement authorities should always be able to obtain as much assistance from their foreign counterparts as they are willing to provide to those counterparts."

In contrast you state on page 22 of your testimony that the SEC should have discretion in this area and reciprocity should be only one factor in deciding whether to help a foreign enforcement authority.

Is this an issue about which the Commission feels strongly? If so, please explain why and also tell us whether you have had an exchange of views on the issue with senior State Department officials.

A.1. The recently introduced legislation requires that before the Commission may provide assistance, the requesting authority must agree to provide the Commission with similar investigative assistance. No doubt, this amendment would thus provide a substantial incentive for foreign securities authorities to enter into mutual assistance arrangements with the Commission or to make commitments to provide information in similar situations. However, the Commission is concerned that it could also tie the Commission's hands in cases where assistance may be justified and appropriate but where a foreign authority is not in a position to make a commitment to provide similar assistance.

The Commission anticipates that it will rarely grant assistance to foreign authorities that would be unwilling to reciprocate by responding favorably to a Commission request. However, there may be cases in which the Commission might conclude that granting assistance to a foreign authority will promote the development of a mutual assistance relationship. A "reciprocity" requirement would unnecessarily restrict the Commission in its relationships with foreign securities authorities and would limit the Commission's ability to provide assistance even when doing so would advance the Commission's goal of protecting the U.S. markets. For these reasons, we would propose deleting this requirement for similar assistance and adding it as a factor which the Commission must consider in determining whether, in its discretion, assistance should be made available. The Commission has discussed this matter with both the State and Justice Departments.

Q.2 You state on page 24 of your testimony that Section 24(d) of the proposed legislation would authorize the Commission to withhold from disclosure documents obtained from a foreign securities authority if the foreign authority has in "good faith" represented to the Commission that public disclosure of such records would be contrary to the laws of the foreign country.

This Section, I understand, would not prevent the Commission with complying with a request for information from Congress - is that correct? Could or would the commission restrict in any way Congress' use of such information before making it available?

A.2. The amendment would add a new Section 24(e) to make clear that the amendment would not prevent the Commission from complying with a request for information from the Congress or from complying with an order of a court of the United States in an action commenced by the United States or the Commission. This amendment would replace the current last sentence of Section 24(b) of the Exchange Act, which provides that "nothing in this subsection shall authorize the Commission to withhold information from the Congress." This amendment would not give the Commission the authority to restrict access to Congress of information in the Commission's files or the manner in which Congress may use any information so provided.

Q.3 I have a question that goes beyond the legislation presently before us. Former Commissioner Bevis Longstreth in a March speech at the Columbia Law School voiced concerns that increasing internationalization of securities markets could lead to a "competition among regulators" that might require the paring down of some of the SEC's investor protection concerns. The quandary for the SEC, he said, was "whether to protect U.S. investors somewhat less by lessening the traditional rules, or by sticking to those rules to protect not at all as U.S. investors go offshore and U.S. markets erode against the foreign competition."

Is this a growing concern for the Commission? Are efforts being make to agree on international standards for investor protection? If so, is any progress being made?

A.3. The focus of the Commission's approach to internationalization is to develop domestic regulations and foreign understandings which protect investors in the U.S. markets from foreign-based fraud. Moreover, as discussed more fully in my written submission to the Subcommittee, the Commission is working with international organizations such as the International Organization of Securities Commissions and the Organization for Economic Cooperation and Development ("OECD") to promote cooperation and understanding about the manner in which we regulate securities markets in the U.S. The premise that other countries are interested in protecting the integrity of the markets is borne out by the results of a recent Commission initiative at the OECD concerning cooperation in international securities enforcement matters, discussed in my written submission to the Subcommittee, as well as by the reaction of foreign countries to recent major scandals involving international securities trading.

Q.4 In your testimony you speak in favor of the provisions of the proposed legislation that would authorize the commission to impose sanctions on American securities professionals for violations of foreign laws. On page 33 you state if the American "professional makes a persuasive due process or jurisdictional attack on the foreign adjudicative proceedings, the Commission may be required to permit relitigation of the underlying offense."

I take it that if the Commission finds the American professional makes a persuasive attack on the justice of the foreign conviction you would not exercise the discretion given by this provision to impose sanctions. It seems, however, that you are saying here that the Commission's decisions in this area would also be subject to review by the Courts. Is that correct?

A.4. Any sanction which the Commission imposes against a securities professional may be reviewed by the U.S. Courts of Appeals.

RESPONSES OF CHAIRMAN DAVID S. RUDER TO SUPPLEMENTAL QUESTIONS

Questions for Mr. Ruder from Senator Riegle from June 29, 1988

Q.1. Has the Commission ever denied assistance to a foreign country in a securities case which it felt and agreed ought to be pursued because of a lack of authority to do so?

A.1. On occasion the Commission staff has received requests for assistance where it was unable to obtain a formal order of private investigation -- subpoena power -- to provide the requested assistance. This situation is increasing as a result of the Memoranda of Understanding ("MOUs") which the Commission has negotiated. These MOUs create a new mechanism for requests and, as a result of increasing internationalization of securities transactions, the Commission and its foreign counterparts are utilizing this avenue for assistance more frequently.

Q.2. What has been the reaction of foreign countries to the recent flood of major scandals involving international securities trading and what steps have they taken to tighten their securities enforcement?

A.2. In general, we have observed that the Commission's recent international cases have heightened the awareness of foreign countries of the need for developing and improving mechanisms to facilitate the prevention and prosecution of international securities fraud. In addition, we note that countries such as Switzerland, Japan and the Netherlands as well as organizations such as the European Community and the Council of Europe have either enacted or are in the process of considering insider trading legislation.

Q.3. Has any major investigation you would have liked to pursue or have been pursuing been stalled, delayed, or discontinued as a result of a lack of foreign cooperation?

A.3. While the Commission has not closed a case solely because of a lack of foreign assistance, there are cases where, because no agreement or understanding exists, the Commission has had to pursue alternative approaches to satisfy its investigatory needs. Such approaches are time-consuming and expensive and do not provide a predictable and reliable method for pursuing matters.

Q.4 Do you feel that bilateral agreements such as MOUs are the best means for effectively dealing with international securities fraud?

A.4 Yes, MOUs create a direct relationship between the SEC and its foreign securities regulator counterpart. As a result, they build on the identity of interests which already exists. They are flexible agreements which can be negotiated with a willing foreign nation and which are responsive to existing problems and problems which the parties anticipate may need to be addressed in the future.

Questions for Mr. Ruder from Senator D'Amato from June 29, 1988

Forcing Cooperation

1. The Commission disagrees with the requirement of reciprocity in cooperation with investigations: If the SEC's mandate is enforcement of this country's securities laws, doesn't required reciprocity give you better leverage in gaining the cooperation of foreign enforcement agencies?

1.A. As discussed in response to Senator Proxmires's question regarding reciprocity, the Commission is concerned that a reciprocity requirement could tie its hands in cases where the provision of assistance could help to persuade a foreign country to provide better and more complete future cooperation.

2. What purpose does it serve to use SEC resources to enforce other country's laws except as a means for obtaining cooperation for enforcement of U.S. laws?

2.A. While the provision of assistance to foreign regulators may require the expenditure of Commission resources, we believe that this expenditure will be more than made up in savings attributable to cases where the Commission obtains assistance from a foreign regulator. As internationalization has increased, the Commission has made numerous requests for assistance from abroad. These requests, in the absence of cooperative agreements, would be time-consuming and expensive. By facilitating cooperation, we believe that the proposed legislation will allow the Commission to reallocate its resources both to efforts to provide reciprocal assistance and to pursue other program areas. Additionally, to the extent Commission assistance to a foreign country results in improved regulation of the internationalized securities markets, it will protect U.S. participants in those markets.

3. Assuming that even with the negotiating leverage afforded the SEC by this bill, there will be some countries that still will not cooperate with your enforcement efforts: Why can't the United States condition access to its capital markets upon cooperation with the SEC's enforcement efforts, i.e.: If country X's banks or securities firms do business in this country, why shouldn't information held by those firm's home offices be available for law enforcement?

3.A. At the current time, it would be very difficult effectively to condition access to the U.S. markets. Access to U.S. markets is often obtained through layers of foreign institutions.

Each institution only knows the identity of its customer, which may be an institution in another country. As a result where a national of one country maintains an account at an institution that goes to an institution in another country to purchase stock in the U.S., the order would be placed in the institution's omnibus trading account with its broker in the U.S. and the nationality or even the identity of the ultimate beneficial owner would not be known to the U.S. brokerage firm or the foreign firm placing the order on the U.S. market.

4. On a related topic: Should we consider making routine disclosure of certain basic information conditional upon access to the U.S. Capital Markets? Is that feasible?

4.A. The Commission and the Congress have considered proposals to require disclosure of certain information as a condition of access. However, such proposals have met stiff resistance and even if adopted, might not prove effective. Therefore, the Commission has determined to pursue bilateral agreements and understandings, which it believes are effective, rather than such a unilateral approach.

Discipline of Securities Professionals

Q.1 What types of foreign securities law violations would trigger action by the SEC?

A.1. Title II of the proposed legislation would add new subsections 15(b)(4)(G) to the Exchange Act, 203(e)(7) to the Investment Advisers Act, and 9(b)(4) to the Investment Company Act. These provisions would apply the proscriptions of Section 15(b)(4)(A), (D), and (E) of the Exchange Act, Section 203(e)(1), (4), and (5) of the Investment Advisers Act, and Section 9(b)(1)-(3) of the Investment Company Act to an international context. Thus, the Commission would be able to impose sanctions on the professional if he has been found by a "foreign financial regulatory authority" -- a defined term in the Acts -- to have made false or misleading statements in registration statements or reports filed with the authority; violated foreign statutory or regulatory provisions regarding securities or commodities transactions; or aided, abetted, or otherwise caused another person's violation of such foreign securities or commodities provisions or failed to supervise a person who has committed a violation of such provisions. The term "foreign financial regulatory authority" would be defined in new Sections 3(a)(51) of the Exchange Act, 202(a)(24) of the Investment Advisers Act, and 2(a)(50) of the Investment Company Act to include a "foreign securities authority" or organization that is essentially equivalent to a self-regulatory organization. The term "foreign securities authority," in turn, is defined in new Sections 3(a)(50) of the Exchange Act, 202(a)(23) of the Investment Advisers Act, and 2(a)(49) of the Investment Company Act as "any foreign government or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws relating to securities." Section 15(b)(6) of the Exchange Act and Section 203(f) of the Investment Advisers Act authorize the Commission to limit activities of a person associated or seeking to become associated with a broker-dealer or investment adviser if the Commission finds that the person has committed any of the acts or has been convicted or enjoined as designated in Section 15(b)(4) or Section 203(e). Because Title II requires the addition of new paragraphs in Section 15(b)(4) and Section 203(e), the legislation will provide for conforming amendments to Section 15(b)(6) and Section 203(f). Title II would also make conforming amendments to Sections 15B(c), 15C(c), 15C(f) and 17A(c) of the Exchange Act.

Q.2. Would a judgement by a foreign agency be prima facie cause for disciplinary action? Who would bear the burden of proof in such an action?

A.2. The Commission's action against a securities professional would not be automatic. The statutory procedure for imposing sanctions for foreign misconduct would be the same as that currently in place for imposing sanctions for domestic misconduct. The Commission would provide the securities professional with notice and an opportunity for a hearing prior to taking such action. The securities professional would thus have an opportunity to present evidence on his own behalf, in order to demonstrate that the imposition of sanctions would not be in the public interest. In addition, if the professional makes a persuasive due process or jurisdictional attack on the foreign adjudicative proceedings, the Commission may be required to permit relitigation of the underlying offense. In such a case, the foreign finding of misconduct would provide the basis for a Commission administrative proceeding even though principles of collateral estoppel might not be available to the Commission. Similarly, in a Commission review, pursuant to 15 U.S.C. 19(d)-(f), of an SRO disciplinary or membership proceeding against a person subject to a statutory disqualification, the Commission might find it necessary to remand the proceeding to the SRO for relitigation of the underlying offense in cases where persuasive due process or jurisdictional challenges to the foreign proceeding are made.

Effectiveness of MOU Mechanism

1.Q. Among the countries that provide a haven for violators of securities laws, which ones are the biggest problems?

1.A. The Commission works closely with the Department of Justice to develop approaches to countries from which it needs information. The Commission has not publicly identified particular countries which have been uncooperative. Rather, we have attempted to resolve our difficulties, through participation in international organizations, the development of MOUs, and working through the Department of Justice channels.

2.Q. Are you negotiating with them?

2.A. The Commission and the Department of Justice are currently negotiating or attempting to open discussions with many of the countries which have secrecy and blocking laws that have been encountered in Commission investigations.

3.Q. Will the authority in this legislation bring about negotiations? A Memorandum of Understanding?

3.A. The Commission believes that the authority in the proposed legislation will make possible the negotiation of more far-reaching memoranda of understanding which will enhance the Commission's ability to obtain evidence from abroad.

4.Q. Who are you negotiating with now?

4.A. The Commission has ongoing negotiations with Australia and France. We are discussing entry into negotiations with several other European countries. Further, on July 1, 1988, the Commission signed a Memorandum of Understanding with the Brazil Comissao de Valores Mobiliarios, its securities regulatory counterpart in Brazil.

5.Q. How many MOUs do you have in place? With Whom?

5.A. The Commission has MOUs with the Brazil Comissao de Valores Mobiliarios, the Ontario, Quebec and British Columbia Securities Commissions, the United Kingdom Department of Trade and Industry, the Japanese Ministry of Finance and the Government of Switzerland.

Exemption from Freedom of Information Act

1.Q. What kinds of information is currently confidential under the secrecy laws of:

A. Panama?
B Netherlands Antilles?
C. Bahamas?

1.A. As we understand the situation, each of these three countries have laws which apply to banking matters, pursuant to which all customer and other account information concerning a bankers' customer generally would be kept secret. However, in at least one instance, SEC v. Dennis Levine, the SEC was successful in urging the Attorney General of The Bahamas to state unilaterally to the bank involved that Bahamian secrecy laws did not prevent the production of securities trading documents and customer identifying information to the Commission.

2.Q. Would the FOIA exemption provided by this bill encourage greater secrecy? (A country could get SEC cooperation in enforcing its laws but actually increase its own level of financial secrecy.)

In other words, does the scheme in this bill do anything to reduce the disparity between the degree of disclosure required in the U.S. sector and other sectors of the international securities market?

2.A. The proposed Section 24(d) would supersede the FOIA by authorizing the Commission to withhold from disclosure documents obtained from a foreign securities authority if the foreign authority has in "good faith" represented to the Commission that public disclosure of such records would be contrary to the laws of the foreign country. The term "foreign securities authority" would include government agencies and self-regulatory organizations which "administer" or "enforce" the securities laws. While Panama, the Netherlands Antilles and the Bahamas have banking secrecy laws, the proposed legislation would not affect these statutes and would not increase the level of financial secrecy. Indeed, the amendment would not restrict the Commission's use of the information and documents obtained from a foreign authority in its investigations or for enforcement purposes. Nor would it limit the ability of the Congress to obtain information in the Commission's possession or preclude defendants in actions commenced by the United States or the Commission from seeking, through discovery or otherwise, such documents.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM MARY MOCHARY

Q.1 What has been the reaction of foreign countries to the recent flood of major scandals involving international securities trading and what steps have they taken to tighten their securities enforcement?

A. Recent U.S. enforcement actions taken with respect to fraudulent international securities trading has focused public and governmental attention on the seriousness of the problem and the need to take effective action to control it. As a result, there has been an increased interest in the development of effective domestic laws and regulations to control illegal conduct.

A number of countries including Switzerland, the Netherlands, Japan and Belgium are considering or have recently adopted insider trading legislation.

Heightened awareness of the abuses which take place in the securities field have also provided additional impetus for increased international cooperation. Enforcement of our securities laws in the international context has long been a subject of discussion with foreign governments; the SEC, in close coordination with the State Department, has participated in such discussions within the OECD (on conflicting jurisdictional requirements) and within the Council of Europe (on insider trading). We believe the desire of foriegn governments to enter into bilateral cooperative agreements for the exchange of information with the SEC is an especially salutary development.

Q.2 What has been the reaction of foreign countries to SEC unilateral and bilateral actions in the area of securities enforcement?

A. As noted in the State Department's testimony, the response of foreign governments to unilateral enforcement measures (i.e., efforts to coerce the production of documents or information located abroad through the imposition of sanctions against a U.S. person or entity) has been overwhelmingly negative. Most foreign government view such efforts as an illegitimate exercise of extraterritorial jurisdiction, and resist them strenuously. By comparison, most foreign governments welcome a cooperative, bilateral approach and will assist the United States to the extent provided by their domestic laws and regulations. Because the latter approach has proven more productive and efficient, the SEC has not threatened or taken unilateral measures since 1981, and instead encourages negotiation of bilateral agreements of the type the current legislation would facilitate.

RESPONSE TO WRITTEN QUESTION OF SENATOR PROXMIRE FROM MARY MOCHARY

Q.3 You state on page 4 of your testimony that the State Department supports the reciprocity provision in the legislation we are considering because it would assist us in getting other nations to cooperate with us in this area. In contrast Mr. Ruder states on page 22 of his tesitmony that the SEC is concerned that a reciprocity provision could "tie the Commission's hands in cases where assistance may be justified and appropriate, but where a foreign authority is not in a position to make a commitment to provide similar assistance." Mr. Ruder believes the SEC should have some discretion on this matter. Can you explain to us why the State Department disagrees with Mr. Ruder on this issue and whether it is a matter that the Department feels strongly about? Please explain.

A. The State Department believes that international assistance in criminal matters should be "mutual" and not a one way street. American authorities should always be able to obtain as much assistance from their foreign counterparts as they are willing and able to provide to those counterparts. Predicating assistance on the basis of reciprocity can serve as a powerful inducement to foreign governments to enter into balanced bilateral agreements with U.S. authorities that will effectively serve shared law enforcement objectives. Where a foreign government is "not in a position to make a commitment to provide similar assistance" because it lacks the domestic legal authority to do so, a reciprocity requirement can motivate that government to seek the necessary authority.

This does not mean, however, that there must be an exact parallel between the authorities granted to U.S. and foreign enforcement authorities by their respective laws, or that the SEC should be disabled from providing assistance pursuant to an agreement negotiated in good faith simply because the foreign government has not yet received implementing authority. The State Department agrees that, in this respect, it may well be helpful for the Commission to have some discretion granting a foreign request for assistance when it would further legitimate law enforcement goals. We do not think it would be appropriate, however, to authorize the Commission to respond affirmatively to any foreign request without regard to the willingness or ability of the requesting government to assist U.S. authorities on a reciprocal basis.

U.S. Department of Justice

Washington, D.C. 20530

STATEMENT

OF

MARK M. RICHARD
DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

FOR THE RECORD OF THE HEARING OF

THE SUBCOMMITTEE ON SECURITIES
OF THE SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

CONCERNING S. 2544, THE INTERNATIONAL SECURITIES
ENFORCEMENT AND COOPERATION ACT OF 1988

JUNE 29, 1988

Chairman Riegle and members of the Subcommittee:

I am pleased to present the position of the Department of Justice on S. 2544, the International Securities Enforcement and Cooperation Act of 1988. In the Department's view, this is an important legislative initiative which will aid in international cooperation to assist and enhance the enforcement of securities laws. The Department believes that measures such as S. 2544 are exceptionally important to law enforcement efforts in general.

On April 20, 1988, I had the opportunity to present the Department's position regarding six mutual legal assistance treaties to the Senate Committee on Foreign Relations. On behalf of the Department, I urged Senate ratification of those treaties as being in the best interest of United States law enforcement. The negotiation and implementation of effective mutual legal assistance treaties (MLATS) and executive agreements is a very important aspect of our effort to investigate and prosecute serious crime. As this Subcommittee knows all too well, we have in recent years seen the internationalization of serious crimes such as narcotics trafficking, money laundering, terrorism, and large scale fraud. As a result, it has become increasingly common that significant evidence in major criminal cases will be found abroad. Obtaining such evidence, particularly in a form that will be admissible in our courts, has not been an easy matter. The purpose of our MLATS is to provide a reliable and efficient means of obtaining this evidence. Agreements such as those contemplated by S. 2544 are likely to pave the way to additional mutual legal assistance treaties.

The provisions of this legislation have been analyzed and its merits are clear. The Department particularly supports provisions of S. 2544, which would provide:

(1) authority for the Commission to conduct an investigation upon the request of a foreign regulatory authority; and

(2) explicit Commission rulemaking authority to provide nonpublic documents and other information to foreign authorities.

As Senator Donald W. Riegle pointed out in introducing the bill, it will "provide the Securities and Exchange Commission with important tools to deal with enforcement problems arising from the internationalization of the securities markets." The Department believes this goal is admirable and S. 2544 is well suited to achieving that goal.

The Criminal Division of the Department of Justice has enjoyed a close working relationship with the Commission's Enforcement Division. Issues involving jurisdictional overlaps have been harmoniously resolved in the past. The Commission briefed the Department on the progress of the legislation, its import, and its impact. The Commission and Department met to discuss coordination of the negotiation of, and operation under, the Commission agreements contemplated to implement the proposed legislation. Both parties quickly reached an agreement on the following points with respect to implementing the legislation and the attendant anticipated agreements:

(1) Prior to instituting a formal investigation at the request of a foreign securities authority, the Commission will provide a designated official of the Department of Justice ("DOJ Official") with a copy of the request and will allow the DOJ Official a reasonable amount of time to provide any comments to the Commission staff;

(2) The Commission will give the DOJ official notice of its determination to commence an action pursuant to Section 21(c) of the Securities Exchange Act of 1934 to enforce any subpoena issued at the request of a foreign securities authority pursuant to a formal order of private investigation:

(3) In any case involving enforcement of a subpoena issued at the request of a foreign securities authority, where the Commission determines that criminal sanctions should be sought, the concurrence of the appropriate officials of the Department of Justice will be obtained prior to the initiation of any proceeding seeking

the imposition of such sanctions;

(4) The Commission staff will consult with the Department of Justice Office of International Affairs regarding the selection of countries for negotiation of Memoranda of Understanding and the content of such Memoranda of Understanding; and

(5) In cases where the Department of Justice or a United States Attorney wishes to request assistance from the Commission which requires the use of a Commission Understanding with a foreign securities authority, requests will be directed to the Commission staff through the Department of Justice Office of International Affairs.

Given the understanding between the Commission and the Department, the Department heartily endorses the proposed legislation as a positive step to advance the cause of international cooperation in the area of law enforcement.

United States Department of State

Deputy Secretary of State

Washington, D.C. 20520

June 29, 1988

Dear Mr. Chairman:

While I regret that I am unable to appear before your Subcommittee today, I would like to express my support for the principal underlying S. 2544, the "International Securities Enforcement Cooperation Act of 1988", and our appreciation to you for today's hearing on this proposal.

Legislation of this type will assist cooperative efforts on an international level to regulate the securities markets. The increasing internationalization of those markets makes such enforcement cooperation essential, especially with our closest allies and principal trading partners.

As you know, before becoming Deputy Secretary of State, I spent 38 years in investment banking on Wall Street. I believe I can speak with some considerable experience, therefore, when I say that legislation of the sort now before the Subcommittee is important from both the securities regulation and foreign policy perspectives. In my view it will not only promote better law enforcement cooperation with our friends, it will help protect Americans trading in U.S. markets from foreign-based fraud and promote the kind of fair securities markets we want to see develop around the world.

Sincerely,

John C. Whitehead

The Honorable
Donald W. Riegle, Jr., Chairman,
Securities Subcommittee,
Senate Committee on Banking, Housing and Urban Affairs,
United States Senate.

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